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BEFORE THE ARIZONA CORPORATION COMMISSION

Jeff Hatch-Miller
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Commissioner

Marc Spitzer
Commissioner

Mike Gleason
Commissioner

Kristin K. Mayes
Commissioner

IN THE MATTER OF THE JOINT NOTICE OF INTENT OF VERIZON COMMUNICATIONS INC. AND MCI, INC.	Docket No: T-01846B-05-0279 T-03258A-05-0279 T-03475A-05-0279 T-03289A-05-0279 T-03198A-05-0279 T-03574A-05-0279 T-02431A-05-0279 T-03197A-05-0279 T-02533A-05-0279 T-03394A-05-0279 T-03291A-05-0279

NOTICE OF FILING COMMENTS ON STATE PREEMPTION

In accordance with the first ordering paragraph and Paragraph 22(b) of Decision 68348 that requires Verizon Communications Inc., to file in this docket copies of all petitions and/or comments filed at the Federal Communications Commission or with

LEWIS AND ROCA LLP LAWYERS

Congress which seek preemption of state regulation, Verizon Communications Inc. submits the attached "Comments of Verizon" and "Reply Comments of Verizon" filed with the Federal Communications Commission in WC Docket No. 05-342 on January 23, 2006 and February 13, 2006, respectively, and "Comments of Verizon on Video Franchising" filed with the Federal Communications Commission in MB Docket No. 05-311 on February 13, 2006.

RESPECTFULLY SUBMITTED this 17th day of February, 2006.

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By: [signature]

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:	)	
	)	
Petition of BellSouth Telecommunications, Inc.	)	WC Docket No. 05-342
For Forbearance Under 47 U.S.C. § 160 from	)	
Enforcement of Certain of the Commission's	)	
Cost Assignment Rules	)	

Comments of Verizon[1]

INTRODUCTION

Given the market and technological changes detailed by BellSouth, it is imperative that the Commission assure that carriers are not subject to unnecessary regulatory burdens. In particular, the Commission should immediately extend the separations freeze and confirm that the freeze precludes states from imposing inconsistent separations requirements. In addition, as the states and Commission eliminate economic regulation, the Commission ultimately should eliminate separations requirements altogether, but only if and when it preempts any inconsistent state rules in order to avoid a proliferation of burdensome and unnecessary cost allocation requirements. The Commission also should eliminate archaic rules that artificially inflate the cost assigned to non-regulated operations and affiliates; those rules make no sense in today's market, where all services are subject to competition. Finally, as with separations, the Commission should ensure that inconsistent state transfer pricing rules are preempted as well. Deregulation does not create a regulatory vacuum, but rather represents a binding and preemptive national policy.

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1 The Verizon telephone companies (Verizon) are listed in Attachment A.

ARGUMENT

I. THE COMMISSION SHOULD PROMPTLY EXTEND THE SEPARATIONS FREEZE

A. The Reasons Underlying the Freeze Apply Even More Strongly Today Than They Did When The Freeze Was Adopted.

The Commission should promptly extend the separations freeze on an interim basis pending fundamental separations reform. The Commission instituted the freeze in 2001 in order to "reduce regulatory burdens on carriers during the transition from a regulated monopoly to a deregulated, competitive environment in the local telecommunications marketplace." *Separations Freeze Order*, ¶ 13. The Commission also explained that the freeze was warranted in light of "rapid changes in the telecommunications infrastructure, such as the growth in Internet usage and the increased usage of packet switching" as well as "other new technologies, such as digital subscriber line (DSL) services," *id.* ¶¶ 1, 12, which "may call into question the continued validity of usage-based separations procedures designed for circuit-switched technologies and services." *Id.* ¶ 12 n.32. As BellSouth's Petition demonstrates, all of the factors the Commission considered when initially adopting the separations freeze apply with even greater force today.

For example, the original purpose of the separations rules was "to prevent ILECs from recovering the same costs in both the interstate and intrastate jurisdictions." Petition, at 43. BellSouth points out that all of the states in BellSouth's territory have moved from rate-of-return regulation to price cap regulation, which "no longer rely on cost information for ratemaking purposes." *See* Petition at 23-39.[2] As competition increases and regulation decreases, there is increasingly no justification to continue to impose *<u>any</u>* regulatory accounting burdens on ILECs,

[2] By contrast, several of the states in which Verizon provides local telephone service continue to regulate rates based on Verizon's rate of return. Regardless of the relief granted to BellSouth, Verizon does not seek forbearance from the separations rules for its local telephone companies at this time.

including jurisdictional separations. Until the transition away from economic regulation is fully complete, the Commission should work to minimize the significant administrative burdens associated with the cost allocation rules. Services have become far more competitive, so requiring ILECs to perform detailed separations analyses – while CLECs and other competitors do not have similar burdens – undermines the Commission's goals of achieving competitive neutrality. *Id.*, at 43-45, 72-76. Moreover, networks have become more complex, and no longer break down easily into the cost assignment rules developed decades ago. *Id.*, at 62-65.

For these reasons, US Telecom has urged the Commission to adopt a Notice of Proposed Rulemaking to address jurisdictional separations reform, and to concurrently grant an interim extension of the current separations freeze. *See* United States Telecom Association White Paper, Paving the Way for Separations Reform, CC Docket No. 80-286 (filed Dec. 13, 2005) ("US Telecom White Paper"). As US Telecom explained, the Commission should act promptly in order to ensure the stability and simplification adopted in the initial freeze are not undermined by uncertainty about whether the current freeze will expire on June 30, 2006. *Id.*, at 1 ("With only six months to go until the freeze is set to expire, carriers already are in the untenable position of having to either make considerable investments in an effort to resuscitate their ability to perform separations studies, or sit tight and hope that the Commission ultimately will decide to retain the freeze.").

The Commission must not permit the freeze to expire or otherwise resurrect the "astonishingly detailed methodology," Petition at 43, inherent in the pre-freeze separations process. Under that process, carriers had to perform more than 475 separate studies, and Verizon alone devoted "at least 60 employees and 11 major computer systems … to maintaining the separations data bases and performing separations calculations." Comments of Verizon on Joint

Board Recommended Decision, CC Dkt No. 80-286, at 2 (Sept. 25, 2000). Gearing up to reinstate that process would be a mammoth undertaking, as US Telecom explained in its White Paper (at 2):

> the costs associated with once again performing facility studies would include additional manpower, program updates, and updates to the provisioning databases to ensure the necessary fields are populated to retrieve separations-type information. The programs that were used to prepare facilities results have not been maintained since the inception of the separations freeze and would need to be validated in order determine whether they are even workable at this point. Feeder system field updates and hardware/software system updates could dictate reprogramming of the facility study programs. The people who maintained those programs prior to the freeze are no longer in place, and new staff would have to be hired and trained. Likewise, the expertise to perform full traffic and facility studies no longer exists, and carriers would have to start from close to scratch to revive these study groups. ... [T]he separations-related fields that were maintained in the provisioning databases could be in total disrepair, because those fields are not required for normal provisioning of customers.

There is no legitimate basis for requiring carriers to incur this expense and disruption. By maintaining the freeze, the Commission can avoid imposing undue burdens on carriers while considering whether to adopt a more comprehensive reform of its separations rules.

B. The Commission Should Reaffirm That States Cannot Impose Separations Rules That Are Inconsistent With The Freeze.

Carriers cannot be subjected to inconsistent state and federal cost allocation rules. Having to comply with varying state requirements in addition to federal rules governing the same investment and expenses would be unreasonably burdensome, impede competition, and delay or foreclose the introduction of innovative services.

In particular, the Commission should not create or tolerate a situation where the same investment is split between two different jurisdictions in two different ways. Just as the separations rules are intended to assure against double recovery of the same costs in two jurisdictions, they must not permit states to deny recovery of costs that are properly assigned to the intrastate jurisdiction. Accordingly, in conjunction with extending the freeze, the

Commission should reconfirm that states cannot require carriers to perform separations studies or take other actions that are inconsistent with the separations freeze while the freeze is in effect. Some state regulators or regulatory staff have taken the position that Verizon must reallocate major portions of its network investment to the interstate private line category.[3] That position is inconsistent with the *Separations Freeze Order* because it would compel Verizon to conduct investment studies in order to determine which portions of certain types of investment are used exclusively for providing interstate services.

The *Separations Freeze Order* explicitly states that price cap carriers "will not have to perform the analyses necessary to categorize annual investment changes for interstate purposes" and further explains that, "[b]ecause a goal of the freeze is to reduce administrative burdens on carriers . . . any Part 36 requirement to segregate costs recorded in Part 32 accounts into categories, subcategories, or further sub-classifications shall be frozen at their percentage relationship for the calendar year 2000." *Separations Freeze Order*, ¶¶ 14, 22.[4] Although the *Order* notes that categories or portions of categories that had been directly assigned prior to the freeze should continue to be directly assigned, it makes clear that no investment studies are required: "facilities that are utilized *exclusively* for services within the state or interstate jurisdiction are readily identifiable, [so] the continuation of direct assignment of costs [for those

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3 *See Investigation into a Successor Incentive Regulation Plan for Verizon New England, Inc., d/b/a Verizon Vermont*, Dkt No. 6959, *Order* (Vt. Pub. Serv. Bd. Sept. 26, 2005). Similar arguments have been presented in an ongoing docket of the Maine Public Utilities Commission. *See* Direct Testimony of Robert Loube, Ph. D., on behalf of the Office of Public Advocate, Dkt No. 2005-155 (Maine Pub. Util. Comm'n Sept. 26, 2005).

4 Similarly, the Joint Board's *Recommended Decision* regarding the freeze explained that "carriers will not have to perform the analyses necessary to categorize annual investment changes for interstate purposes. The major divisions of separations, such as central office equipment (COE) and [cable and wire facilities (C&WF)] investment will be allocated to the categories and, where appropriate, subcategories for the given year based on the frozen category relationships." *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, Recommended Decision, 15 FCC Rcd. 13160, ¶ 19 (2000) (emphasis added).

categories] will not be a burden." *Id.* ¶ 23 (emphasis added). In contrast, if plant is used for both interstate and intrastate purposes, the categories, sub-categories, and subclassifications containing that plant, and the allocation of those categories, subcategories, and subclassifications, remains frozen at their 2000 levels.

The Commission should clarify the broad scope of the freeze, in order to prevent states from demanding the reclassification of investment from intrastate to interstate. Not only would such reallocation effectively impose the types of studies and burdens that the freeze was intended to eliminate, but it would result in a state being able to reclassify as "interstate" investment that, under the Commission's rules, must be considered intrastate. Permitting states to engage in such reallocation would undermine not only the freeze, but the entire concept of a unified national approach to jurisdictional separations. *See Crockett Tel. Co. v. FCC*, 963 F.2d 1564, 1567 (D.C. Cir. 1992) ("Although each state has great freedom to regulate intrastate rates, once the FCC has applied its jurisdictional separation, that part of the cost base deemed to be interstate is outside the jurisdictional reach of the state regulatory agency."), *id.* at 1573 ("when the Commission has prescribed an applicable separation methodology, states are not free to ignore it"); *see also Hawaiian Tel. Co. v. Public Utilities Commission of Hawaii*, 827 F.2d 1264, 1275-76 (9th Cir. 1987), *cert. denied*, 487 U.S. 1218 (1988) (finding a state ratemaking methodology to be inconsistent with and thus "necessarily preempted" by federal separations methodology).

C. The Commission Ultimately Should Eliminate Separations, But Must Concurrently Preempt Any Inconsistent State Requirements

Ultimately, the Commission should eliminate separations requirements altogether. In a market where all services – interstate, intrastate, wireline, wireless, local, long distance, basic, and enhanced – are competitively disciplined, regulatory cost allocation requirements such as the separations rules are not only unnecessary to protect ratepayers, but destructive of true competition.

The Commission should only eliminate the separations rules, however, if it concurrently preempts any state rules determining allocation of costs between the federal and state jurisdictions. Without such preemption, the benefits of forbearance at the federal level would be lost and carriers would be subject to dozens of different state separations regimes, with far greater regulatory burden than the current unitary systems.[5]

Under longstanding preemption principles, such inconsistent state rules cannot be permitted. First, Section 10(e) expressly prohibits the states from enforcing federal rules from which the Commission has forborne. 47 U.S.C. § 160(e). Permitting state regulation that is similar to the federal regulation (though perhaps not sharing every detail) would effectively violate that provision and thus be prohibited. *See, e.g., Richmond Power and Light of City of Richmond, Ind. v. FERC*, 574 F.2d 610, 620 (D.C. Cir. 1978) ("What the Commission is prohibited from doing directly it may not achieve by indirection."); *Kinney v. Weaver*, 111 F.Supp.2d 831, 840 (E.D.Tex. 2000) ("[N]umerous cases have held that governmental entities cannot do indirectly that which they cannot do directly."); *Littell v. Udall*, 242 F.Supp. 635, 640 (D.D.C. 1965) ("It would be wholly unrealistic for this Court to accept the Secretary's interpretation of this statute so as to permit him to do indirectly what he cannot do directly.").

Moreover, any state regulation of separations, whether or not similar to the foreborne federal rule, would effectively negate the Commission's judgment that forbearance serves the public interest. Not only would regulation continue, notwithstanding the Commission's

5 This approach would not violate Section 2(b), 47 U.S.C. § 152(b). States could still regulate intrastate rates in accordance with their chosen regulatory regime (*e.g.*, price caps or rate base); they just could not require a specific allocation of costs between the interstate and intrastate jurisdictions.

judgment that regulation is no longer necessary (or even harmful), but the situation would be even worse than before the Commission granted forbearance. For these reasons, any inconsistent state cost allocation rules must be preempted as upsetting the policy balance wrought by the Commission using its forbearance authority. See *Buckman Co. v. Plaintiffs' Legal Comm.,* 531 U.S. 341, 348 (2001) (finding obstacle preemption where "somewhat delicate balance of statutory objectives" could "be skewed by allowing" state-law claims); *Geier v. American Honda Motor Co.*, 529 U.S. 861, 881 (2000) (a rule of state tort law that imposed a duty contrary to the "mix" of options permitted by federal regulations is conflict-preempted); *Edgar v. MITE Corp.*, 457 U.S. 624, 634 (1982) (finding obstacle preemption where state law "upset the careful balance struck by Congress").[6]

II. THE GROWTH OF COMPETITION UNDERMINES ANY NEED FOR DETAILED AFFILIATE TRANSACTION RULES.

As BellSouth explains in great detail, the rule governing valuations of services and assets transferred between regulated and non-regulated affiliates (§ 32.27), and the Cost Allocation Manual and independent audit requirements, to the extent they relate to the affiliate transaction rule (§§ 64.903, 64.904, and 32.9000), serve no continuing purpose in assuring just and reasonable rates and protecting ratepayers. To the contrary, these rules "represent a formidable obstacle to meeting the demands of the evolving marketplace and giving consumers the innovative products and services they desire." Petition at 32.

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6 Thus, this is not a case where either the policy adopted by the Commission is outside its authority or the impacts of state regulation could be limited to the intrastate sphere and thus not infringe on the Commission's valid federal policy. *Cf. Louisiana Pub. Serv. Comm. v. FCC*, 476 U.S. 355 (1986). The Commission has unquestioned authority to adopt binding separations rules. 47 U.S.C. §§ 221(c), 410(c); *Crockett Tel. Co., supra.* Moreover, state rules allocating costs between the state and federal jurisdictions cannot be limited in their impact to the intrastate jurisdiction. Rather, once the Commission has decided that a certain portion of costs should be allocated to the interstate jurisdiction – or that costs need no longer be separated at all – any such state rule inevitably would interfere with that decision. *See Louisiana PSC*, 476 U.S. at 375 n.4.

These rules are burdensome and often inject months of delay into the development and deployment of new services. Customers increasingly expect innovative bundles of regulated and non-regulated services, which may include inputs from multiple affiliates. The affiliate transaction rules add to the complexity of designing these offerings and distort purchasing decisions, by requiring needless and resource-intensive cost allocation exercises. For example, even where there is a clear market price for a service that is transferred from one affiliate to another, that price cannot automatically be used for regulated affiliate transfer pricing. Rather, transfers of services from a non-regulated affiliate to a regulated affiliate must be priced at the higher of cost or market value, and transfers in the other direction must be priced at the lower of cost or fair market value. 47 C.F.R. § 32.27(b), (c) (net book cost is used for assets and the tariffed rate or fully distributed cost for services).

Even if these requirements didn't make it harder for LECs to compete, which they do, they are unnecessary in the current market environment. As the Commission has long recognized, robust competition such as that typifying all segments of today's communications industry assures that rates will be just, reasonable, and nondiscriminatory. *See, e.g.*, *Implementation of Sections 3(n) and 332 of the Communications Act, Second Report and Order*, 9 FCC Rcd 1411, ¶ 174 (1994) ("[c]ompetition, along with the impending advent of additional competitors, leads to reasonable rates."), *id.* ¶ 173 ("in a competitive market, market forces are generally sufficient to ensure the lawfulness of rate levels, rate structures, and terms and conditions of service ...."); *see also Policy and Rules Concerning the Interstate, Interexchange Marketplace, I*, 11 FCC Rcd 20730, ¶ 42 (1996); *Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities*, First Report and Order, 85 F.C.C.2d 1, ¶ 88 (1980) ("firms lacking market power simply cannot rationally price their services in ways which, or impose terms and conditions which, would contravene Section 201(b) and 202(a) of the Act"). In today's market, competition from wireless carriers, cable companies, VoIP providers, CLECs and other new entrants, constrains the rates that incumbent local exchange carriers can charge for their services. Perpetuating superfluous and burdensome cost allocation and inter-affiliate transaction rules in this environment undermines competition and disserves consumers. Moreover, once the Commission has forborne from these rules, it must preempt states from establishing their own regulations governing affiliate transactions, for the reasons discussed in Section I.C above.

CONCLUSION

For the foregoing reasons, the Commission should extend the separations freeze on an interim basis pending fundamental separations reform, reaffirm that states cannot impose inconsistent cost allocation rules on carriers (including but not limited to separations rules that are inconsistent with the separations freeze), and move toward eliminating federal rules governing separations and inter-affiliate transfer pricing while concurrently preempting any inconsistent state requirements.

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January 23, 2006

Michael E. Glover
Of Counsel

THE VERIZON TELEPHONE COMPANIES

The Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc. These are:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Southwest Incorporated d/b/a Verizon Southwest
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:	)	
	)	
Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. § 160 from Enforcement of Certain of the Commission's Cost Assignment Rules	)	WC Docket No. 05-342

Reply Comments of Verizon

Verizon's opening comments urged the Commission to extend the separations freeze on an interim basis pending fundamental separations reform, reaffirm that states cannot impose inconsistent cost allocation and separations rules on carriers, and move toward eliminating federal rules governing separations and inter-affiliate transfer pricing while concurrently preempting any inconsistent state requirements. Competition assures that all market participants – including incumbent LECs, competitive LECs, cable telephony providers, and wireless carriers – must charge reasonable rates, rendering these antiquated regulatory obligations both unnecessary and inimical to full and fair competition. The few comments suggesting perpetuation or even expansion of these requirements are meritless and must be rejected.

I. THE SEPARATIONS FREEZE MUST BE EXTENDED PENDING COMPREHENSIVE REFORM AND INCONSISTENT STATE REQUIREMENTS MUST BE PREEMPTED.

In the 2001 *Separations Freeze Order*, the Commission properly noted that the separations process imposes undue burdens on carriers in a competitive environment and is based on measurements that make little sense in an increasingly packet-switched network. *Jurisdictional Separations and Referral to the Federal-State Joint Board*, Report and Order, 16 FCC Rcd 11382, ¶¶ 1, 12-13 (2001). BellSouth's forbearance petition establishes that those considerations weigh even more heavily in favor of a freeze today and underscores the need for the Commission both to extend the freeze and to prohibit state actions that are inconsistent with the freeze pending further reform – and eventual elimination – of the separations process. *See* Verizon Comments at 2-8.

Notwithstanding the growing irrelevance and indisputable burden of jurisdictional cost assignments, the New Jersey Division of Ratepayer Advocate asks the Commission to allocate more costs to the interstate jurisdiction, citing the Commission's decision to treat DSL as an interstate service. New Jersey Division of Ratepayer Advocate Comments, WC Docket No. 05-342, at 10-11. This suggestion is misguided. It makes no sense to expend scarce resources trying to resurrect an analysis that (1) is supposed to provide only a rough justice allocation,[1] and (2) was frozen in order to "reduce regulatory burdens on carriers during the transition from a regulated monopoly to a deregulated, competitive environment in the local telecommunications marketplace," *Separations Freeze Order*, ¶ 13, a transition which is essentially complete.

The New Jersey Division of Ratepayer Advocate's concern that the existing separations rules permit over-recovery of costs from intrastate customers is baseless, given widespread competition from cable telephony, wireless carriers, independent VoIP providers, and wireline CLECs. Moreover, the always-arbitrary nature of jurisdictional cost allocations has been exacerbated by the growing prevalence of distance- and usage-insensitive services that defy jurisdictional classification. As the Commission recently observed, "as more services are offered over a single loop, cost allocations are likely to become more arbitrary and thus less reasonable." *Appropriate Framework for Broadband Access to the Internet over Wireline Facilities*, Report

1 *See Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148 (1930) ("the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measure being essential").

and Order and Notice of Proposed Rulemaking, 20 FCC Rcd 14853, 14928 n.434 (2005).[2] Accordingly, the course of action suggested by the New Jersey Division of Ratepayer Advocate is unnecessary, impractical, and would saddle incumbent LECs with costs that they can ill-afford to bear in a competitive marketplace.

II. THE COMMISSION SHOULD ELIMINATE THE AFFILIATE TRANSACTION RULES AND PREEMPT INCONSISTENT STATE REQUIREMENTS.

Verizon's Comments (at 8-10) explained that the Commission's affiliate transaction rules are unnecessary and counter-productive in today's competitive environment.[3] In the historical rate-of-return environment, these rules were intended to assure that costs of unregulated operations were not shifted into the rate base and ultimately reflected in higher prices for consumers of regulated services. Today, however, even in those few jurisdictions that still employ rate base regulation, competition prevents incumbent local exchange carriers from raising rates above market-disciplined levels.[4] Accordingly, the affiliate transaction rules serve

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2 Similarly, the Commission noted the futility of trying to devise "cost causality and usage measures" applicable to nonregulated broadband Internet access services: "These measures ... would have to reflect the evolution of the incumbent LECs' networks from traditional circuit-switched networks into IP-based networks. The proceedings to set these measures would be both resource-intensive and, given the changes in network technology from the time when the part 64 cost allocation rules were developed, likely to lead to arbitrary cost allocation results." *Wireline Broadband Order*, ¶ 134. The same holds true in the separations context.

3 In particular, Verizon urged the Commission to forbear from or otherwise eliminate the rule governing valuations of services and assets transferred between regulated and non-regulated affiliates (§ 32.27), and the Cost Allocation Manual and independent audit requirements, to the extent they relate to the affiliate transaction rule (§§ 64.903, 64.904, and 32.9000).

4 *See e.g., Verizon Communications Inc. and MCI Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 05-75, FCC 05-184, at ¶¶ 3, 91 (rel. Nov. 17, 2005) (noting "the rapid growth of intermodal competitors – particularly cable telephony providers (whether circuit-switched or voice over IP (VoIP) – as an increasingly significant competitive force in [the mass] market," anticipating "that such competitors likely will play an increasingly important role with respect to future mass market competition," and explaining that "the record reveals that growing numbers of subscribers in particular segments of the mass market are choosing mobile wireless service in lieu of wireline local services"); Marguerite Reardon, *Verizon Plays Hardball on Pricing*, New.com, Nov. 9, 2005, available at http://new.com.com/Verizon+plays+hardball+on+pricing/2100-1037_3-5942158.html,

no purpose. They do, however, add to the complexity of designing bundled offerings that contain inputs from multiple affiliates, by compelling resource-intensive and time-consuming cost allocation exercises. Accordingly, the Commission should forbear from these rules and simultaneously preempt states from establishing their own regulations governing affiliate transactions.

The New Jersey Division of Ratepayer Advocate (at 20) contends that, as a result of the Verizon/MCI and SBC/AT&T mergers, "the prospects for effective competition are diminishing," making it "premature to discontinue rules governing affiliate transactions." To the contrary, the Commission's order approving the Verizon/MCI merger expressly found that "significant public interest benefits are likely to result from this transaction." *Verizon Communications Inc. and MCI Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, WC Docket No. 05-75, FCC 05-184, at ¶ 2 (rel. Nov. 17, 2005). Moreover, the Commission expressly "reject[ed] commenters' arguments that consumers will be worse off after the merger," *id.* ¶ 105, observing that "intermodal competitors, including facilities-based VoIP and mobile wireless providers, are likely to capture an increasing share of mass market local and long distance services." *Id.*[5] Consequently, these recent mergers do not compel retention of the antiquated affiliate transaction rules.

("Verizon Communications has reduced rates on its traditional telephony service to new lows as it tries to compete with cable companies who are now offering telephony as part of their own packages."); *see also* Viktor Shvets & Andrew Kieley, Deutsche Bank, *Consumer Wireline Erosion: The Strategic Response to "Water Torture"* at 2 (May 19, 2005) ("access line losses will escalate over the next 12 months towards 6%, and possibly as high as 8% per annum, driven by wireless cannibalization, rapid take-off of cable telephony, and proliferation of non-facilities-based VoIP services.").

5 Likewise, the Commission found that "there are numerous categories of competitors providing services to enterprise customers. These include interexchange carriers, competitive LECs, cable companies, other incumbent LECs, systems integrators, and equipment vendors." *Id.* ¶ 64.

III. SPECIAL ACCESS RATES ARE JUST AND REASONABLE, AND ARMIS-REPORTED RATES OF RETURN ARE MISLEADING AND IRRELEVANT.

Ad Hoc resurrects its tired claim that the special access returns reported in ARMIS are excessive and that the Commission must drastically reduce special access rates. Ad Hoc Comments, WC Docket No. 05-342, filed Jan. 23, 2006, at 4-10; *see also* Time Warner Telecom Comments, WC Docket No. 05-342, filed Jan. 23, 2006, at 9-10. Ad Hoc fails to recognize that returns on particular services are both meaningless from an economic standpoint and irrelevant to determining whether rates are just and reasonable. While ARMIS accounting reports and data serve certain oversight and regulatory purposes for the Commission, the agency well understands that evaluating the reasonableness of price cap rates is neither an intended nor a possible use of those data. *See generally, 1998 Biennial Regulatory Review*, 14 FCC Rcd 11443, 11448 (1999). As a result, accounting rates of return reported in ARMIS do "not serve a ratemaking purpose." *Policy and Rules Concerning Rates for Dominant Carriers*, 6 FCC Rcd 2637 ¶ 199 (1991). Moreover, special access rates are competitively disciplined, with dozens of facilities-based competitors operating wherever there is appreciable special access demand. *See* Comments of Verizon, WC Docket No. 05-25, filed, June 13, 2005, Declarations of Quintin Lew and Eric Bruno. And the Commission's price cap and pricing flexibility rules – in which rate of return no longer serves any purpose – act as a further, albeit unnecessary, backstop.

In any event, Verizon has thoroughly refuted Ad Hoc's claim that special access rates are excessive in its filings in WC Docket No. 05-25. Those filings establish that: (1) Verizon's overall special access revenues per line have dropped by 16.6 percent per year in real terms since 2001, even as special access lines grew by 15.3 percent per year over the same time period. (2) Individual special access service rates fell as well. Between 2002 and 2004, DS1 and DS3 prices paid by customers fell by 5.7 and 7.6 percent per year respectively in real terms. (3) Verizon offers special access discount plans with price breaks of 40 percent or more off month-to-month rates and individually negotiated contract tariffs with total discounts of up to 70 percent off month-to-month rates. Ad Hoc raises no new arguments here, and its claims should be rejected.

IV. CONCLUSION

For the foregoing reasons, and those contained in Verizon's Comments, the Commission should extend the separations freeze on an interim basis pending fundamental separations reform, reaffirm that states cannot impose inconsistent cost allocation rules on carriers (including but not limited to separations rules that are inconsistent with the separations freeze), and move toward eliminating federal rules governing separations and inter-affiliate transfer pricing while concurrently preempting any inconsistent state requirements.

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February 13, 2006

Federal Communications Commission

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Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:	)	
	)	
Implementation of Section 621(a) of the Cable Communications Policy Act of 1983 as Amended by the Cable Television Consumer Protection and Competition Act of 1992	)	MB Docket No. 05-311
	)	

COMMENTS OF VERIZON ON VIDEO FRANCHISING

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February 13, 2006

TABLE OF CONTENTS

SUMMARY i

BACKGROUND 1

DISCUSSION 9

I. The Cable Act Prohibits Common Problems with the Franchising Process that Prevent Competitive Entry and Burden the First Amendment Interests of Competitive Video Providers, and the Commission Has Authority to Enforce Those Prohibitions...... 9

A. The 1992 Cable Competition Act Was Aimed at Encouraging Video Competition By Limiting LFAs' Discretion to Deny Competitive Entry. 10

B. The First Amendment Also Mandates Limited Discretion for LFAs. 16

C. The Commission Has Authority To Adopt Binding and Preemptive Rules to Interpret and Enforce the Provisions of the Cable Act, Including Section 621(a). 21

1. The Commission Has Authority to Interpret and Enforce the Cable Act. 21

2. The Commission's Rules Are Preemptive and Binding. 23

II. The Commission Should Adopt Rules Addressing the Several Common Local Franchising Practices that Violate Section 621(a), Other Provisions of the Cable Act, and the First Amendment to the Constitution. 27

A. The Delay Commonly Associated with Obtaining a Competitive Franchise Frustrates the Purposes of Section 621(a), and the Commission Should Impose Reasonable Time Limits on the Franchising Process. 30

1. Delay Is Rampant in the Franchising Process. 31

2. The Commission Should Impose Reasonable Time Limits on the Franchising Process. 35

B. Unreasonable Build-Out Requirements Should Be Preempted. 39

1. Some LFAs Demand Unreasonable Build-Out by New Entrants. 41

2. The Cable Act Permits New Entrants to Define Their Own Franchise Areas 42

3. The First Amendment Limits the Build-Out That May Be Required. 47

4. At a Minimum, Relevant Differences Between Incumbents and New Entrants Must Be Considered 51

C. Demands for Fees or Concessions Beyond Those Permitted by the Cable Act Unreasonably Burden Competitive Entry and Are Preempted. 54

1. Funding for Pet Projects Unrelated to Video Services Are Subject to Franchise Fee Limitations. 57

2. Large "Application" or "Acceptance" Fees and LFA Attorneys or Consultants Fees Are Prohibited Except to the Extent Chargeable as Franchise Fees. 59

3. Franchise Fees for Non-Cable Services Are Prohibited. 62

D. Many Common PEG Demands Are Contrary to Federal Law and Invalid 64

E. Most Demands for Institutional Network Facilities or Support Are Invalid. 72

F. Local Assertions of Regulatory Control over Non-Cable Services Are Barred. 75

G. So-Called "Level Playing Field" Requirements That Act as Barriers to Entry Should Be Preempted. 76

III. The FCC Should Construe the Act's "Cable System" Definition in Accordance with Section 621 and Other Provisions of the Act and the First Amendment. ..80

A. The Entirety of a Mixed-Use Broadband Network Is Not a "Cable System." 82

B. The Commission Possesses Preemptive Authority To Construe the Act. 87

CONCLUSION 89

SUMMARY

In the *Franchise NPRM*,[1] the Commission asked whether the local franchising regime creates an unreasonable barrier to entry that deters video competition and broadband deployment, and whether there is anything the Commission can do about it. The answer to both questions is "yes."

Verizon is upgrading its existing network by deploying a new fiber-to-the-premises ("FTTP") network to millions of homes and businesses, the largest-ever investment in facilities that can be used to provide competitive video services as well as advanced telecommunications and data services. In connection with the addition of video services to this advanced broadband network, Verizon has undertaken negotiations with hundreds of local franchising authorities ("LFAs") across the country. And, based on this first-hand experience, there is no question that the current local franchising process generates unwarranted delays and is engrained with overreaching practices – most of which are unlawful under the Cable Act and the First Amendment – and all of which are encouraged by incumbent cable operators in an effort to hinder competitive entry into the video market. Accordingly, in order to provide consumers with the full benefits that will result from prompt entry into the video marketplace and the widespread deployment of advanced broadband networks, the Commission should adopt rules to implement Section 621(a)'s command that LFAs not "unreasonably refuse to award an additional competitive franchise." Moreover, the Commission should confirm that any municipal effort to impose added regulations – under the auspices of cable franchising authority – on the

[1] Notice of Proposed Rulemaking, *Implementation of Section 621(a) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992*, MB Docket No. 05-311, FCC 05-189, ¶ 11 (rel. Nov. 18, 2005) ("*Franchise NPRM*").

construction and operation of a national, mixed-use broadband network would violate federal law and policy and is preempted.

The vast majority of American households currently have no choice in wireline video services other than the incumbent cable company in their area. The result is higher (and ever-increasing) prices and poorer service for cable subscribers. The GAO has found that wireline cable competition exists in less than 2 percent of all communities, but that in those areas, cable prices average approximately 15 percent lower while customer service improves.[2] The Commission reported similar findings in its most recent report on cable pricing, noting that "[f]or communities [with wireline overbuild competition], the monthly cable rate and price per channel were, respectively, 15.7 percent lower and 27.2 percent lower than those averages for the noncompetitive group."[3] Meanwhile, in the more than 98 percent of communities lacking wireline competition, prices have continued to soar, rising between 40 and 50 percent over the last five years – more than four times as fast as the Consumer Price Index. *2005 Cable Pricing Report*, Attachment 4. Thus, the costs to consumer from delaying wireline video competition is significant, and while estimates vary, the costs to consumers run into the billions and may be as

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[2] U.S. General Accounting Office, *Telecommunications: Subscriber Rates and Competition in the Cable Television Industry*, Testimony of Mark L. Goldstein, Director of Physical Infrastructure Issues, Before the Senate Committee on Commerce, Science and Transportation, GAO-04-262T, at 6 (Mar. 25, 2004) ("*GAO Mar. 2004 Cable Competition Report*"); U.S. General Accounting Office, *Telecommunications: Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, Report to the Chairman, Senate Committee on Commerce, Science and Transportation, GAO-04-8, at 3-4 (Oct. 24, 2003) ("*GAO Oct. 2003 Cable Competition Report*").

[3] Report on Cable Industry Prices, *Implementation of Section 3 of the Cable Television Consumer Protection and Competition Act of 1992*, 20 FCC Rcd 2718, ¶ 12 (2005) ("*2005 Cable Pricing Report*"). The Commission has suggested that wireline competition only exists in approximately 400 if the 33,485 cable communities nationwide – or approximately 1.2 percent of communities. *See* Eleventh Annual Report, *Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming*, 20 FCC Rcd 2755, ¶ 26, App. B. at Table B-1 (2005) ("*2005 Cable Competition Report*").

much as much as $16 billion to $28 billion in net present value, depending on future entry assumptions. *See* Hazlett Decl. ¶¶ 50-52 & Exh. 1, attached hereto as Attachment B.

These facts underscore the significance of the efforts that Verizon and other new entrants are making to enter the video market on a large scale and compete head-to-head with incumbent cable providers, thus finally providing consumers with a meaningful choice in video service providers. Yet Verizon's efforts have been made significantly more difficult by the outdated and burdensome local franchising process that persists in many jurisdictions and the incumbent cable operators who interfere in and exploit that process.[4] As the Commission recognized as long ago as its first annual report on video competition in 1994, "[t]he local franchise process is, perhaps, the most important policy-relevant barrier to competitive entry in local cable markets."[5] This remains true today, as Verizon's experience confirms. Moreover, because the revenue stream made possible by the provision of video services is an important component of the business case for investment in the deployment of advanced broadband networks, the barriers that the local franchising process creates to realizing that revenue stream undermine federal policies meant to encourage broadband deployment.

The local franchising process is inherently slow and expensive, requiring a provider who seeks to compete on a wide scale to go town-to-town and individually negotiate hundreds or thousands of separate agreements. The franchising process originally developed to provide cable companies with access to the public rights-of-way. Local authorities generally granted an

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[4] The history of cable incumbents using the franchising process as a barrier to competitive entry is well documented, and has resulted in the demise of many otherwise promising "overbuilder" ventures throughout the country. *See, e.g.*, *2005 Cable Competition Report* at ¶ 73.

[5] *Implementation of Section 19 of the Cable Television Consumer Protection and Competition Act of 1992, Annual Assessment of the Status of Competition in the Market for Delivery of Video Programming*, 9 FCC Rcd 7442, Appendix H at ¶ 43 (1994) ("*First Video Competition Report*").

exclusive franchise to one cable operator, and in return, the municipality generally received a variety of payments and other concessions from the monopoly provider. This framework makes little sense today when competitive providers who already have access to the rights-of-way seek to offer competitive video services over their broadband networks. Preventing them from doing so serves no legitimate purpose, and deprives consumers of a competitive alternative for video service while also undercutting the incentives to invest in and deploy the broadband networks over which competitive video services will be delivered. Ultimately, therefore, the answer is to eliminate the current locality-by-locality franchising process, which affirmatively undermines the important federal policies favoring video competition and broadband deployment.

Even short of a comprehensive overhaul of the franchising regime, there are important steps that the Commission should take to improve the process and encourage video competition and broadband deployment. This is because the inherent problems with a local franchising requirement are greatly compounded by several recurrent practices and abuses – most of which are contrary to the express provisions of the Cable Act – that make the process of obtaining a franchise much more difficult and expensive. And these barriers to competitive entry are particularly troublesome and unnecessary in the case of a provider who already has authority to use the rights-of-way to deploy the broadband network over which it will offer video services.

First, the process is often marked by inordinate delay. Most of the ongoing franchise negotiations that Verizon is engaged in already have gone on for more than six months, and some as long as 19 months. For example, in one community in Virginia, Verizon initiated franchise negotiations in July 2004. Now, after coming close to agreement on a couple of occasions and having had to restart negotiations three times with different attorneys, Verizon still does not have a franchise. Some of the delay Verizon experiences is the result of inattentiveness or complicated procedural requirements by LFAs. At other times, delay is used by some LFAs as a negotiating tactic to extract conditions and concessions from a new entrant. And incumbent cable operators do everything they can to insert themselves into, and delay, the process in order to forestall competition. While the process drags on, the incumbent is able to take steps to further entrench its monopoly position and to make it more difficult for a new entrant to compete successfully.

Second, competitive entry is frustrated by the imposition of unreasonable build-out requirements. When Verizon upgrades its network to FTTP, it does so on a wire center basis, and typically does so throughout the area served by that wire center without regard to the community or neighborhood in which customers live. A particular wire center may not serve the entirety of a community, or it may serve parts of several different communities. Therefore, the areas served by Verizon's fiber network do not correspond neatly to the boundaries of an incumbent cable operator's franchise area or an LFA's jurisdiction. Nonetheless, some LFAs would ignore Verizon's network architecture and require it to offer video services to all households within those areas before Verizon can obtain a franchise, even when some of those households are not served by the wire center that has been upgraded. Particularly given the fact that any one wire center may touch parts of several different jurisdictions, that approach could make the costs grow exponentially, thus rendering deployment uneconomic in some areas. Moreover, in some cases incumbents and LFAs have taken the extreme position that Verizon even must serve customers who live completely outside of its telephone service area where it has no facilities at all. This is the position that has been taken by a consortium of communities in California who maintain that Verizon must serve all households in all of the communities as a condition of receiving a franchise, even though large parts of those communities are completely outside of Verizon's service area. Requiring build-out in such circumstances will, in many cases, prevent any customers in such a jurisdiction from obtaining an additional competitive choice.

Finally, many LFAs use the franchising process as an opportunity to demand all manner of additional concessions, mostly unrelated to the provision of video services or the underlying purposes of franchise requirements, from the would-be competitor. These demands range from exorbitant "application" fees and attorneys fees – often in the tens or hundreds of thousands of dollars – to fiber extended to traffic lights. Often, these demands are couched as being for public, educational, and governmental use support ("PEG") or for institutional networks, even when the things demanded fall outside of what the Act authorizes in those regards. For example, some communities have sought free or discounted Internet access service or cell phone service for themselves or their employees. Others have sought a flat 3 percent fee – on top of the 5 percent cable franchise fee – to "support" PEG, without ever showing that this fee is used for that purpose. And some communities have even tried to leverage the cable franchising authority in order to receive additional fees or control over non-cable services, like telephone and Internet access. Collectively, these illegitimate demands add substantial delay and cost for a competitor seeking to enter the market.

As the Commission correctly recognized in the *Franchise NPRM*, it has ample authority under existing law to dramatically improve the current state of affairs. In particular, the Commission has authority to enforce Section 621(a) of the Act, by promulgating preemptive and binding rules that will eliminate persistent barriers to entry in the video market. In Section 621(a), Congress prohibited the unreasonable refusal to grant a competitive franchise and set out a limited set of factors that an LFA is permitted to consider when reviewing an application for such a franchise. And the Commission's authority to act in this context is strengthened by Section 706 of the 1996 Act, which requires the Commission to remove barriers to the widespread deployment of broadband and other advanced services. These clear statutory mandates, combined with the Commission's duty to avoid the substantial First Amendment problems that would result from allowing an LFA unfettered discretion to decide whether a provider may engage in protected speech, compel the Commission to adopt rules that tightly constrain LFA discretion and prohibit overreaching or other abuse of the franchising process. Thus, the Commission should immediately take two important steps to address some of the most troublesome aspects of the current regime.

First, the Commission should adopt rules enforcing the Congressional mandate in Section 621(a) that franchising authorities may not "unreasonably refuse to award" a competing franchise. Among other things, the Commission should adopt rules to prevent certain common franchising practices – such as unreasonable delays, unreasonable build-out requirements, or other unlawful demands – that violate the Cable Act and amount to a per se "unreasonabl[e] refus[al] to award an additional competitive franchise." These are roadblocks to competitive entry that serve no legitimate governmental purpose, frustrate federal communications policy, and violate the First Amendment. The Commission should confirm that each of these frequently encountered roadblocks to competitive entry is impermissible under Section 621(a) and several other provisions of the Cable Act, as well as under the First Amendment.

Second, the Commission should foreclose LFAs from adopting an impermissibly broad view of their authority over mixed-use, broadband networks like FTTP. Some LFAs and incumbent cable providers have suggested that once Verizon adds video to its FTTP network, the entirety of the physical network suddenly becomes a "cable system" for all purposes, and claim that this provides broad, new authority to a municipality to regulate the construction, operation and placement of the network. These parties have even gone so far as to claim that a municipality may require the provider to "entirely re-build" its network at the direction of the municipality once video is added, even though the mixed-use broadband network was constructed pursuant to, and in compliance with, an independent grant of authority under federal and state telecommunications laws. The Commission should foreclose these arguments once and for all by issuing a binding and preemptive ruling to enforce the proper scope of municipal regulatory authority – and the limited reach of the "cable system" definition – in the context of mixed-use, broadband networks. Here again, Section 706 compels Commission action to remove the barrier to capital investment in broadband facilities created by these misplaced arguments.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:	)	
	)	
Implementation of Section 621(a) of the Cable Communications Policy Act of 1983 as Amended by the Cable Television Consumer Protection and Competition Act of 1992	)	MB Docket No. 05-311

COMMENTS OF VERIZON[6] ON VIDEO FRANCHISING

The current local franchising regime generates unwarranted delays and is rife with overreaching that hinders prompt competitive entry into the video market, contrary to Section 621(a) of the Cable Act, and undermines important federal policies favoring widespread deployment of advanced broadband facilities and services. The Commission should adopt binding federal rules to enforce Section 621(a) and other related Cable Act provisions that place explicit limits on what may be required of a competitive provider as a condition of receiving a franchise. Moreover, the Commission should recognize that any municipal effort to impose added regulations – under the auspices of cable franchising authority – on the construction and operation of a national, mixed-use broadband network would violate federal law and policy and is preempted.

BACKGROUND

For decades, the local franchise process has served to protect the incumbent cable companies from meaningful wireline competition. At first, this protection came in the form of

[6] The Verizon companies ("Verizon") are the affiliated local telephone companies of Verizon Communications Inc. These companies are listed in Attachment C.

exclusive franchises granted by most local franchising authorities. Even after Congress prohibited exclusive franchises, de facto exclusivity has remained the rule rather than the exception as incumbent cable operators and some LFAs have pushed for conditions on competitive franchises that generally have made entry uneconomical. The delay and abuses associated with the current franchising regime – often encouraged and compounded by the incumbents – continue to limit the scope of head-to-head wireline video competition.

The history of how cable regulation and the local franchising process developed helps to reveal the source of many of the continuing problem areas with the existing franchising regime. Soon after the first cable systems began to be deployed starting in the late 1940s, local governments assumed a significant regulatory role, generally premised on their interest in managing public rights-of way.[7] Because these local authorities generally lacked "established or uniform decision-making criteria," and "were not fully equipped to make a reasoned decision as to why one application was 'better' than another," the local franchising process was from the beginning "relative chaos." *All About Cable* § 4.02[1].

As LFAs gained appreciation for the value of the franchises that they were granting and the leverage that their franchising power gave them, the process took a turn for the worse and LFAs almost universally began to grant exclusive franchises that foreclosed competition within each local market. "[G]overnment officials . . . quickly understood that if just one franchise were granted, it would be a valuable commodity for which the city could obtain a high price." *All About Cable* § 4.02[1]. Many LFAs thus began "to view the franchising process solely as a

[7] Nancy Klotz, *Hostile Takeovers of Cable Television MSOs: Who Should Protect the Public Interest*, 39 Fed. Comm. L. J. 123, 124 (1987).

revenue raising device."[8] At the same time, the franchising process became "intensely political," and at its worst exhibited "improper influence, bribery, and conspiracy."[9]

These problems were exacerbated by the cottage industry of outside franchising consultants that developed to help LFAs extract the most possible value from the franchising process. Among other things, these consultants performed "exorbitant studies," [10] which in turn were used to develop expansive requests for proposals based on a community's "needs and interests." *All About Cable* § 4.02[1].

Congress addressed the regulation of cable for the first time when it adopted the Cable Communications Policy Act of 1984 ("1984 Cable Act"). This Act, adopted only after much of the country already had been balkanized into exclusive franchise territories, endorsed the local franchising requirement and provided that "a franchising authority may award . . . [one] or more franchises within its jurisdiction." Pub. L. No. 98-549, § 621(a)(1), 98 Stat. 2779 (1984). Although the 1984 Cable Act did not mandate exclusive franchises, it also did not prohibit them. And the local franchising process continued with business as usual throughout the 1980s, with "little or no competition for cable operators," leading up to the Cable Television Consumer Protection and Competition Act of 1992 ("1992 Cable Competition Act"). [11]

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[8] Robert F. Copple, *Cable Television and the Allocation of Regulatory Power: A Study of Governmental Demarcation and Roles*, 44 Fed. Comm. L. J. 1, 23-24 (1991); *see also* Daniel Brenner, *Cable Television and the Freedom of Expression*, 1988 Duke L. J. 329 (1988) ("[C]able television developed before a national policy was in place as to who should regulate it, and that that scheme should be.").

[9] William E. Lee, *The New Technology in the Communications Industry: Legal Problems in a Brave New World*, 36 Vand. L. Rev. 867, 870 (1983); *see also* Copple, *supra* at 23-24; Brenner, *supra* at 347; Edward H. Lewis, *Municipal Ownership of Cable Television Systems*, 68 N.C. L. Rev. 1295, 1302-03 (1990) ("collusion and graft were commonplace in the franchising process").

[10] Klotz, *supra* at 127

[11] Kathy L. Cooper, *The Cable Industry: Regulation Revisited in the Cable Television Consumer Protection and Competition Act of 1992*, 1 Comm. Law Conspectus 109, 112-13 (1993).

With the 1992 Cable Competition Act – and later with the Telecommunications Act of 1996 ("1996 Act") – Congress sought to effectuate a dramatic policy shift by forcing LFAs finally to open the doors to video competition. Among other things, Congress prohibited LFAs from awarding an "exclusive franchise" or from "unreasonably refus[ing] to award an additional competitive franchise." 47 U.S.C. § 541(a)(1). And, as addressed in detail below, Congress provided a limited list of factors on which LFAs may refuse to grant a franchise application. *See* 47 U.S.C. § 541(a). These provisions were intended to strictly cabin LFA discretion in granting franchises, and to facilitate competitive entry into the video market.

Despite Congress' express intent, the previous abuses of the franchising process have continued generally unabated, and wireline competition has failed to materialize in most places. The GAO has found that wireline cable competition exists in less than 2 percent of all communities. That is *not* because such competition has little market effect: to the contrary, in those areas, cable prices average approximately 15 percent lower while customer service improves.[12] The Commission reported similar findings in its most recent report on cable pricing, noting that "[f]or communities [with wireline overbuild competition], the monthly cable rate and price per channel were, respectively, 15.7 percent lower and 27.2 percent lower than those averages for the noncompetitive group."[13] Meanwhile, in the 98 percent or more of communities that lack wireline competition, prices have continued to soar, rising between 40 and 50 percent over the last five years – more than four times as fast as the Consumer Price Index. *2005 Cable Pricing Report*, Attachment 4. Thus, as the attached declaration of Thomas Hazlett explains, the

[12] GAO Mar. 2004 Cable Competition Report at 6; GAO Oct. 2003 Cable Competition Report at 3-4.

[13] *2005 Cable Pricing Report* at ¶ 12. The Commission has suggested that wireline competition only exists in approximately 400 if the 33,485 cable communities nationwide – or approximately 1.2 percent of communities. *See 2005 Cable Competition Report*, App. B. at Table B-1.

costs to consumer from delaying wireline video competition is significant, and could be as high as $16 billion to $28 billion net present value, depending on future entry assumptions. *See* Hazlett Decl. ¶¶ 50-52 & Exh. 1.[14]

Experience with Verizon's video service offering – FiOS TV – confirms the concrete consumer benefits that result from more competition. Verizon has offered a more attractive array of services than cable offers and at competitive prices. *See* Declaration of Marilyn O'Connell ¶ 6, attached hereto as Attachment A.[15] In the first three months that FiOS TV was available in Keller, Texas, more than 20 percent of the homes to which the service was available signed up. O'Connell Decl. ¶ 7. And, as would be expected, competition has led to swift and substantial benefits for all customers in the newly competitive markets where FiOS TV is available. *See id.* ¶ 7. In areas where FiOS TV is now available, incumbent cable operators have offered price cuts of 28-42 percent, although they generally have "not actively advertised" these discounts or made them available to areas not served by FiOS TV.[16]

The pockets of wireline video competition like Verizon is offering remain limited, however, largely as a result of local franchising requirements. As an initial matter, the very nature of the franchise system leads to anticompetitive effects that make it difficult for a competitor to enter and compete efficient in the video market. The franchise requirement forces

[14] Another recent study confirmed the significant harm to consumer welfare from delaying video competition – in their estimation, $8.2 billion for one year of delay and $29.9 billion for four years of delay. George S. Ford and Thomas M. Koutsky, *"In Delay There Is No Plenty": The Consumer Welfare Cost of Franchise Reform Delay*, Phoenix Center Policy Bulletin No. 13, at 13 (Jan. 2006).

[15] As one analyst noted of FiOS TV, "Verizon's video service offers better value than cable at the low, mid and high ends." Credit Suisse First Boston Equity Research, *VZ Launches FiOS TV; Who's Most Exposed?,* at 3 (Sept. 26, 2005).

[16] Bank of America Equity Research, *Battle for the Bundle: Consumer Wireline Services Pricing*, at 10 (Jan. 23, 2006).

a new entrant to telegraph its deployment plans to the incumbent video competitor. And this advance notice that competition is on the way, often months or more before the new entrant is allowed into the market, allows the incumbent not only to take steps to prolong the franchise process and delay the onset of competition – as discussed in detail below – but also to entrench its position in the market before the new entrant has the opportunity to compete. Verizon has already observed this type of behavior in places where it has sought franchises and is deploying FTTP. Allowing incumbents this head start on competition makes it all the more difficult for a new competitor to successfully enter the market and for consumers to make an informed choice among service providers.

But adding to the inherent anticompetitive aspects of the local franchising requirement, several recurrent practices make the process of obtaining a franchise much more difficult and expensive. First, as discussed below in section II(A), the process is often marked by inordinate delay. Most of Verizon's ongoing franchise negotiations already have gone on for more than six months, and some considerably longer. *See* O'Connell Decl. ¶ 9. For example, in one community in Virginia, Verizon initiated franchise negotiations in July 2004. Now, after coming close to agreement on a couple of occasions and having had to restart negotiations three times with different attorneys, Verizon still does not have a franchise. *See id.* ¶ 18. Some of the delay Verizon experiences is the result of inattentiveness or complicated procedural requirements imposed by LFAs. *See id.* ¶ 16. At other times, delay is used by some LFAs as a negotiating tactic to extract conditions and concessions from a new entrant. And incumbent cable operators do everything they can to insert themselves into, and delay, the process to forestall competition.

<u>Second</u>, as discussed below in section II(B), competitive entry is frustrated by the imposition of unreasonable build-out requirements. When Verizon upgrades its network to

FTTP, it does so on a wire center basis, and typically does so throughout the area served by that wire center without regard to the community or neighborhood in which customers live. *See id.* ¶ 23. A particular wire center may not serve the entirety of a community, or it may serve parts of several different communities. Therefore, the areas served by Verizon's fiber network do not correspond neatly to the boundaries of an incumbent cable operator's franchise area or an LFA's jurisdiction. Nonetheless, some LFAs would ignore Verizon's network architecture and require it to offer video services to all households in those areas before Verizon can obtain a franchise, even when some of those households are not served by the wire center that has been upgraded. *See id.* ¶¶ 24-27. Particularly given the fact that any one wire center may touch parts of several different jurisdictions, that approach could make the costs of deployment grow exponentially, thus rendering deployment uneconomic in some areas. *See id.* ¶ 24. Moreover, in some cases incumbents and LFAs have taken the extreme position that Verizon even must serve customers who live completely outside of its telephone service area where it has no facilities at all. This is the position taken by a consortium of communities in California who have maintained that Verizon must serve all households in all of the communities as a condition of receiving a franchise, even though large parts of those communities are completely outside of Verizon's service area. *See id.* ¶ 27. Requiring build-out in such circumstances could, in many cases, prevent customers in such a jurisdiction from obtaining an additional competitive choice.

Finally, as discussed below in sections II(C)-(G), many LFAs use the franchising process as an opportunity to demand all manner of additional concessions, mostly unrelated to the provision of video services or the underlying purposes of franchise requirements, from the would-be competitor. Indeed, even though Verizon has made clear that it will pay franchise fees and provide reasonable PEG capacity consistent with the terms of the Cable Act, franchising authorities nonetheless go much further and demand any number of things that are inconsistent with the statute. These demands range from exorbitant "application" fees and attorneys fees – often in the tens or hundreds of thousands of dollars – to fiber extended to traffic lights. Often, these demands are couched as necessary for PEG support or for institutional networks, even when the things demanded fall outside of what the Act authorizes. For example, some communities have sought free or discounted Internet access service or cell phone service for themselves or their employees. *See* O'Connell Decl. ¶¶ 42, 46. Others have sought a flat 3 percent fee – on top of the 5 percent cable franchise fee – to "support" PEG, without ever showing that this fee is used for that purpose. *See id.* ¶ 32. And some communities have even tried to leverage the cable franchising authority in order to receive additional fees or control over non-cable services, like telephone and Internet access. *See id.* ¶¶ 49-55. Collectively, these illegitimate demands add substantial delay and cost for a competitor seeking to enter the market.

These practices and abuses exacerbate the barrier to entry erected by the local franchising process, with the result that wireline competition is still almost completely nonexistent. And those incumbents who claim, in the name of a "level playing field," that these burdens must be imposed on new entrants because incumbents agreed to them decades ago in exchange for monopoly positions, are simply engaging in a transparent attempt to delay and prevent competition, contrary to Congress' express purposes. As the cable incumbents once explained to Congress, "state laws and regulations that appear to be 'neutral' conditions on the provision of service" may "as historically applied, amount to barriers to new entrants."[17]

[17] *The Communications Act of 1994: Hearing on S. 1822 Before the Senate Commerce Committee* (May 4, 1994) (statement of Decker Anstrom President and CEO National Cable Television Association).

The consumer welfare sacrificed as a result of these practices is particularly senseless in the context of a provider like Verizon who already has authority to deploy the network over which competitive video services will be offered. *See* Hazlett Decl. ¶ 3. Under these circumstances, nothing legitimate is gained by delaying, burdening or preventing the benefits to consumers that will result from prompt entry into the video marketplace and from widespread deployment of advanced broadband facilities and services.

DISCUSSION

I. The Cable Act Prohibits Common Problems with the Franchising Process that Prevent Competitive Entry and Burden the First Amendment Interests of Competitive Video Providers, and the Commission Has Authority to Enforce Those Prohibitions.

In enacting the 1992 Cable Competition Act, Congress decided that consumers would benefit more from competition among video providers than from the exclusive and *de facto* exclusive franchise arrangements that were dominant at the time. Accordingly, Congress imposed a significant new requirement on franchising authorities, providing in Section 621(a) that "a franchising authority may not grant an exclusive franchise and may not *unreasonably refuse to award* an additional competitive franchise." 47 U.S.C. § 541(a)(1)(4).

At the same time, in order to facilitate competition Congress provided LFAs with a limited set of factors that they are permitted to consider in reviewing an application for a franchise, thus expressly delimiting the grounds on which an LFA may refuse to grant a competitive franchise. *Id.* § 541(a)(4). These factors – along with several other provisions of the Cable Act – necessarily cabin the discretion of LFAs when they consider applications for competitive franchises and limit what can be required of a competitive provider as a condition of entering the market.

Both the structure of the Cable Act and the legislative history supporting these provisions confirm the limited permissible scope of LFA discretion. Moreover, apart from the clear terms of the statute itself, the First Amendment also requires strict limits on LFAs' discretion and imposes independent constraints on the franchising process. The requirement that cable operators obtain a local franchise is a prior restraint: it gives local officials authority to grant or to deny permission to engage in protected speech. Such prior restraints trigger heightened constitutional scrutiny and demand procedural protections that are wholly lacking from the current local franchise process. Also, the franchising process places huge incidental burdens on speech that would be permissible only if supported by a substantial government interest – something missing in the context of a provider who already has authority to deploy the network over which it intends to provide service. Therefore, the First Amendment independently demands an appropriate federal framework under Section 621(a) that strictly limits the discretion afforded to LFAs.

In light of these statutory and First Amendment constraints, as a threshold matter LFA discretion must be restricted to the limited set of factors endorsed by Congress, and any demands or conditions that go beyond those factors should be deemed per se unreasonable. And, the Commission should adopt binding and preemptive national rules that effectuate Congress' intent to foster video competition and that reconcile current franchising practices with the express requirements of the Cable Act.

A. The 1992 Cable Competition Act Was Aimed at Encouraging Video Competition By Limiting LFAs' Discretion to Deny Competitive Entry.

With the 1992 Cable Competition Act in general – and Section 621(a) in particular – Congress sought to encourage video competition by preventing precisely the types of franchising practices which continue to frustrate competitive entry into the video market. First, Congress directly prohibited LFAs from granting exclusive franchises or otherwise "unreasonably refus[ing] to award" competitive franchises. 47 U.S.C. § 541(a)(1). Second, Congress curtailed the discretion available to LFAs by expressly limiting their franchising consideration to a limited set of factors. *Id.* § 541(a)(4). With these changes to the Cable Act's provisions, Congress sought to effect a fundamental change in the way that the cable market worked by replacing a monopoly market with a competitive one.

As Congress explained in its findings in support of the 1992 Cable Competition Act, the "average monthly rate [for cable service] ha[d] increased almost 3 times as much as the Consumer Price Index" since the passage of the 1984 Cable Act.[18] It noted that:

> [f]or a variety of reasons, *including local franchising requirements* . . ., most cable television subscribers have no opportunity to select between competing cable systems. Without the presence of another multichannel video programming distributor, a cable system faces no local competition. The result is undue market power for the cable operator as compared to that of consumers and video programmers.

Id. (emphasis added). Congress stated that its policy in the 1992 Cable Competition Act was to "promote the availability to the public of a diversity of views and information through cable television and other video distribution media," to "rely on the marketplace to the maximum extent feasible, to achieve that availability," and to "ensure that cable television operators do not have undue market power vis-à-vis video programmers and consumers." *Id.* § 2(b). In determining how best to further this pro-competitive policy, Congress focused heavily on the barriers to entry posed by the local franchising process and took two important steps.

First, Congress prohibited LFAs from granting exclusive franchises and from "unreasonably refus[ing] to award . . . an additional competitive franchise." 47 U.S.C.

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[18] 1992 Cable Competition Act, Pub. Law 102-385, 106 Stat. 1460, § 2(a) (1992).

§ 541(a)(1). Congress clearly recognized that delay short of a denial or constructive denial would inhibit competition. On its face, therefore, Section 621(a) was intended to reach further, as illustrated by Congress' careful choice of words prohibiting the "unreasonabl[e] refus[al] to award" a competitive franchise, rather than just the unreasonable denial of a franchise application. This choice of language reveals a concern with LFA actions, short of an outright denial, that have the effect of imposing unreasonable delay or erecting other barriers to competitive entry.

In settling on this approach, Congress drew particular guidance from an earlier report from the Commission in which the Commission explained how the "regulatory activities of some local authorities may discourage or even preclude competing cable systems or other competing multichannel media." *See Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service*, MM Docket No. 89-600, FCC 90-276, 67 Rad. Reg. 2d (P&F) 1771, ¶ 131 (1990) ("*FCC Video Recommendation Report*"). The Commission noted in that report that "some jurisdictions have granted exclusive franchises," and stated that this was "an unwise policy in our judgment." *Id.* ¶ 134. In the Commission's view, there was "no valid reason to discourage or forbid competing systems," and the Commission recommended that Congress "amend the Cable Act to forbid local franchise authorities from unreasonably denying a franchise to applicants that are ready and able to provide service." *Id.* ¶¶ 138, 141.

Congress agreed with the Commission on this score, and ultimately used even stronger language than the Commission recommended. The Conference Report explained that "the conferees believe that exclusive franchises are directly contrary to federal policy and to the purposes of [the 1992 Cable Competition Act], which is intended to promote the development of competition." *Conference Report on Cable Television Consumer Protection and Competition Act of 1992*, H.R. Rep. No. 102-862, at 77 (1992) ("*Conference Report*"). The report expressed a desire to prevent LFAs from "artificially protect[ing] the cable operator from competition." [19] *Id.*

Second, Congress restricted the discretion that LFAs have when reviewing applications for competitive franchises by providing a limited set of factors that LFAs are permitted to consider. 47 U.S.C. § 541(a)(4). The new statutory provision expressly delimits the grounds on which an LFA may refuse to grant a competitive franchise, and establishes the outer metes and bounds of legitimate LFA discretion when reviewing a franchise application. First, an LFA may "require adequate assurance" that the new entrant will "provide adequate public, educational, and governmental access channel capacity, facilities, or financial support." *Id.* § 541(a)(4)(B). Second, an LFA may "require adequate assurance" that the new entrant "has the financial, technical, or legal qualifications to provide cable service." *Id.* § 541(a)(4)(C). While the Cable Act may require a cable provider to do certain other delimited things, such as pay franchise fees, those obligations exist apart from the franchise process and are not a permissible basis for denying a competitive franchise so that the provider may enter the market.

The itemized list of factors adopted in Section 621(a) also places an additional limitation on LFA discretion. Specifically, Section 621(a) also instructs *LFAs* that they *must* permit a new entrant "a reasonable period of time to become capable of providing cable service" within the

[19] In Section 625 of the Cable Act, Congress itself recognized that certain obligations imposed on a monopoly provider would not be warranted in a competitive market. 47 U.S.C. § 545. That provision permits an incumbent to seek modification of its franchise obligations that have become "commercial[ly] impracticab[le]." *Id.* Rather than increase the burdens on video providers in a competitive environment, as some would like to do, this provides further evidence of Congress' intent to reduce regulatory burdens in the face of competitive entry.

new entrant's chosen franchise area. *Id.* § 541(a)(4)(A). This factor – which focuses its attention on the LFA rather than the franchise applicant – thus expressly limits even further the discretion afforded to a franchising authority.

Basic principles of statutory construction and the legislative history confirm that Section 621(a) strictly cabins LFA discretion. For example, under the doctrine of *ejusdem generis*, the general requirement that an LFA may not unreasonably refuse to award a second franchise must be read in light of the specific powers that an LFA does have under the statute. *See, e.g., Circuit City Stores v. Adams*, 532 U.S. 105, 114-15 (2001). To the extent that the LFA seeks to impose conditions or delays that are inconsistent with the enumerated and specific requirements of the Act, such conduct cannot be considered reasonable. Likewise, the fact that Congress enumerated a list of items that each relate directly to areas of governmental interest connected with the provision of cable service that Congress deemed legitimate suggests that the imposition of conditions or delays that are unrelated to those interests would be unreasonable. *See, e.g., Leatherman v. Tarrant County Narcotics Intelligence and Coordination Unit*, 507 U.S. 163, 168 (1993) ("*expressio unius est exclusio alterius*").

Moreover, the legislative history confirms Congress' intent to limit LFA discretion to the specified factors. Here again, Congress drew guidance from the Commission's report concerning the obstacles to video competition. In its report, the Commission echoed many of the specific concerns that Verizon details below when it described the problems faced by a new competitor:

> [T]he record in this proceeding reveals competing systems face several problems that can be eased by changing the franchise process. First, cable companies interested in competing with existing franchisees assert that some franchise authorities require second systems to serve the entire market (i.e., "universal service" requirements), thus precluding a more economically feasible incremental approach to service. Second, some

> franchising authorities require new entrants to meet a variety of municipal requirements that apply to existing operators and which, it is argued, are more sustainable for a sole operator. Third, some franchising authorities require second entrants to meet certain requirements, such as the posting of a bond or letters of credit, not imposed on the incumbent.

FCC Video Recommendation Report ¶ 134. The Commission then made a number of recommendations – in addition to banning exclusive and de facto exclusive franchises – for specific changes that should be made to the franchising process:

> Congress should also make it clear that local authorities may not pass rules whose intent or effect is to create unreasonable barriers to entry of potential competing multichannel video providers. Franchise requirements should be limited to appropriate governmental interests, such as establishing requirements concerning public health and safety, repair and good condition of public rights-of-way, and the posting of an appropriate construction bond.

Id. ¶ 141.

Congress embraced these recommendations by adopting in Section 621(a)(4) the list of considerations that it deemed legitimate. The legislative history confirms Congress' intent to restrict LFAs from taking actions that would unreasonably delay or prevent new video services providers from entering the market. Discussing the limited list of factors identified in Section 621(a)(4) that Congress would permit an LFA to consider, the *Conference Report* explains that the factors were intended to "specify that franchising authorities may require applicants for cable franchises to provide adequate assurance" concerning both PEG requirements and the applicant's qualifications, and, by implication, that they could not reasonably require other concessions. *Conference Report* at 78.

The House and Senate Reports on the legislation similarly reveal an intent to cabin LFAs' discretion and foster competition. The House Report endorses the Commission's recommendation that Congress encourage competition by "prevent[ing] local franchise authorities from unreasonably denying a franchise to potential competitors who are *ready and able to provide service*." *House Report on Cable Television and Consumer Protection and Competition Act of 1992*, H.R. Rep. No. 102-628, at 46 (1992) (emphasis added) ("*House Report*"). The House Report then goes on to identify the limited factors that ultimately were included in Section 621(a)(4) as determinative of the "unreasonabl[eness]" of an LFA's refusal to award a competitive franchise. *Id.* at 90. Likewise, the Senate Report indicates that similar factors in the Senate version of the bill were meant to determine the reasonableness of an LFA's actions. *See Senate Report on Cable Television Consumer Protection Act of 1991*, S. Rep. No. 102-92, at 91 (1991) ("*Senate Report*"). Together, these three reports confirm that Congress intended the factors listed in Section 621(a)(4) to limit the factors that an LFA may consider in reviewing a franchise application.

B. The First Amendment Also Mandates Limited Discretion for LFAs.

The First Amendment independently requires strict limits on the discretion afforded to LFAs when considering applications for competitive franchises, and, therefore, it too requires giving effect to the express limits in Section 621(a)(4) on the factors that LFAs may consider. A contrary rule that would permit an LFA to permit or deny the right to engage in protected speech at its unfettered discretion – as some parties would suggest – could not pass constitutional muster. Also, as the Commission recognized in the *Franchise NPRM*, the governmental interest underlying franchising requirements – management of the public rights-of-way – is weak or nonexistent in the case of a would-be provider who already has authority to use the rights-of-way to deploy its network. *Franchise NPRM* ¶ 22 (questioning whether a higher standard for "reasonableness" should apply in this context). Therefore, any restrictions on such a provider's ability to engage in protected speech are particularly suspect.

It is well established that the First Amendment protects cable companies' right to offer video programming services. *Turner Broadcasting Systems v. FCC*, 512 U.S. 622, 636 (1994) ("*Turner I*"); *City of Los Angeles v. Preferred Communications, Inc.*, 476 U.S. 488, 494 (1986).[20] Cable operators express speech not only through their original programming but also through their editorial decisions over which stations and programs to disseminate. As the Supreme Court has observed, cable providers "communicate messages on a wide variety of topics and in a wide variety of formats." *Turner I*, 512 U.S. at 636.

The cable franchising system regulated by Section 621(a) presents special risks to these free speech interests. Like many other licensing or permitting schemes, the cable franchise system requires speakers to obtain permission from local authorities *before* engaging in protected speech. This type of control inherently threatens free expression because it conditions speech on the advance blessing of local authorities – and silences speech until that blessing is received. In addition, by establishing local authorities as gatekeepers, the franchise system places local governments in the position to impose onerous regulatory conditions on cable operators that can deter or even prevent competitive providers from entering the cable market.

At least four First Amendment principles must guide the Commission in this proceeding, and foreclose any expansive view of the discretion left to LFAs when judging an application for a competitive franchise.

First, the doctrine of prior restraints requires that laws subjecting the exercise of First Amendment freedoms to the prior restraint of a license spell out narrow, objective standards related to the proper regulation of public places that will guide the licensor's discretion.

[20] The Supreme Court also has held that companies that operate in whole or in part as public utilities are fully entitled to the protection of the First Amendment. *See Pacific Gas & Elec. Co. v. Public Utilities Commission of California*, 475 U.S. 1 (1986).

Shuttlesworth v. City of Birmingham, 394 U.S. 147, at 150-51 (1969). These standards ensure that those empowered to block the expression of protected speech do not "roam essentially at will, dispensing or withholding permission to speak . . . according to their own opinions" about the expressive activity being licensed. *Id.* at 153. And they safeguard against arbitrary decisions as to how much to charge permit applicants for the right to engage in protected expression.

Applying this doctrine, the Supreme Court has struck down a range of permitting schemes that failed adequately to confine licensing authorities' discretion. For example, in *Shuttlesworth*, the Court held that a regime that allowed local authorities to deny a permit for parades and demonstrations if "the public welfare, peace, safety, health, decency, good order, morals or convenience require that it be refused" did not pass constitutional muster. *Id.* at 149-50 (quoting § 1159, General Code of Birmingham). Similarly, in *City of Lakewood v. Plain Dealer Publishing Co.*, the Court found invalid an ordinance that granted the mayor broad latitude with respect to the issuance of permits to place newsracks on public property. 486 U.S. 750, 772 (1988). In *Lakewood*, the ordinance authorized the mayor to "either deny the application" for a permit or "grant said permit subject to" a range of terms including "such other terms and conditions deemed necessary and reasonable by the Mayor." *Id.* at 754 n.2 (quoting § 901.181, Codified Ordinances, City of Lakewood). These statutory standards, the Court concluded, were "illusory," for they placed "no explicit limits on the mayor's discretion" and authorized him to "grant the application, but require the newsrack to be placed in an inaccessible location without providing any explanation whatever." *Id.* at 769. Finally, in *Forsyth County v. The Nationalist Movement*, the Supreme Court struck down a municipal permitting scheme because it empowered a local administrator to set the amount he would charge for a parade and assembly permit based on his own judgment of "what would be reasonable." 505 U.S. 123, 132 (1992).

Second, any licensing scheme must provide for a prompt administrative decision, in order to prevent a long delay from serving as an effective denial. *See City of Littleton v. Z-J Gifts D-4, L.L.C.*, 541 U.S. 774 (2004); *see also Thomas v. Chicago Park Dist.*, 534 U.S. 316, 324 (2002); *Chesapeake B&M, Inc. v. Harford County*, 58 F.3d 1005, 1012 n.7 (4th Cir. 1995) ("any system of prior restraint must place adequate time limits on the decision-making process").

Third, a locality may not charge speakers for the privilege of exercising their First Amendment rights, except to the limited extent necessary to compensate for the locality's necessary incidental expenses. When considering permit applications, licensing officials can assess only those fees needed "to meet the expense incident to the administration of the [program] and to the maintenance of public order in the matter licensed." *Cox v. New Hampshire*, 312 U.S. 569, 577 (1941) (internal quotation marks omitted); *see also Murdock v. Pennsylvania*, 319 U.S. 105, 113-14 (1943). Any fees exceeding those necessary to cover the costs of administering the licensing scheme are unconstitutional taxes on speech.

Fourth, the First Amendment does not permit governments to impose overly broad burdens on speech, even if such burdens are content-neutral. Regulations burdening speech must "further[] an important or substantial governmental interest; . . . the governmental interest [must be] unrelated to the suppression of free expression; and . . . the incidental restriction on alleged First Amendment freedoms [must be] no greater than is essential to the furtherance of that interest." *Turner I*, 512 U.S. at 662 (quoting *United States v. O'Brien*, 391 U.S. 367, 377 (1968) (internal quotation marks omitted)).

Thus, the First Amendment imposes independent constraints on the power of LFAs to subject applicants to arbitrary processes, to withhold decisions, to exact fees unrelated to actual costs, or to impose onerous conditions on entry. A reading of Section 621(a) that purported to grant LFAs with such authority would violate the First Amendment. And while regulations that give effect to the limits imposed by Congress cannot eliminate the constitutional infirmities inherent in the franchise process and Cable Act themselves, they nonetheless can alleviate some of the most pernicious aspects of the current franchise process. As the Supreme Court has directed, "if an otherwise acceptable construction of a statute would raise serious constitutional problems, and where an alternative interpretation of the statute is fairly possible," the statute must be construed "to avoid such problems." *INS v. St. Cyr*, 533 U.S. 289, 299-300 (2001) (internal citation and quotation marks omitted); *see also Ashwander v. Tennessee Valley Authority*, 297 U.S. 288, 348 (1936) (Brandeis, J., concurring). To contribute to the implementation of the Cable Act in a manner that is most conducive to the important First Amendment values at stake, the Commission should confirm the Act's express limits on LFAs' discretion over the franchise process.

An additional consideration counsels in favor of particular vigilance in policing the constitutional outer limits of LFAs' authority here. The First Amendment demands that any permitting requirement – even one giving officials *no* discretion in deciding whether to grant or withhold a license – must be justified by legitimate governmental interests. *See Watchtower Bible & Tract Society of New York, Inc. v. Village of Stratton*, 536 U.S. 150, 163 (2002). In other words, a locality must have good reasons for adopting a law that tells speakers that they must seek official permission before engaging in protected speech.

LFAs lack legitimate reasons to require such permission here. The cable regulatory regime grants localities franchising authority because of their interest in managing the public rights of way. But providers like Verizon, who develop their wireline facilities pursuant to state and federal telecommunications law, are already authorized to access the public rights of way. They do not need local permission to build their physical network. Ultimately, there is no legitimate reason for localities to subject providers like these to the advance control of a franchise requirement.

C. The Commission Has Authority To Adopt Binding and Preemptive Rules to Interpret and Enforce the Provisions of the Cable Act, Including Section 621(a).

In the *Franchise NPRM*, the Commission tentatively concluded that it "has authority to implement Section 621(a)(1)'s directive that LFAs not unreasonably refuse to award competitive franchises," and that "[u]nder the Supremacy Clause, the enforcement of a state law or regulation may be preempted by federal law when it stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Franchise NPRM.* ¶ 15. The Commission also "tentatively conclude[d] that, pursuant to the authority granted under Sections 621(a) and 636(c) of the Act, and under the Supremacy Clause, the Commission may deem to be preempted and superseded any law or regulation of a State or LFA that causes an unreasonable refusal to award a competitive franchise in contravention of section 621(a)." *Id.* Each of these conclusions is unquestionably correct.

1. <u>The Commission Has Authority to Interpret and Enforce the Cable Act.</u>

The Commission's authority to promulgate rules that interpret and give effect to the provisions of the Cable Act is well established. The Supreme Court has repeatedly confirmed that the Commission has general rulemaking authority to effectuate the provisions of the

Communications Act, including the Cable Act. *See, e.g., AT&T Corp. v. Iowa Utilities Board*, 525 U.S. 366, 378 (1999); *see also* 47 U.S.C. § 151 (granting the Commission authority to "execute and enforce" the provisions of the Communications Act). In fact, the Seventh Circuit already has upheld the Commission's authority to interpret Section 621's franchising requirements. *See City of Chicago v. FCC*, 199 F.3d 424, 428 (7th Cir. 1999). In that case, the court confirmed that "the FCC is charged by Congress with the administration of the Cable Act," and concluded that the court was "not convinced that for some reason the FCC has well-accepted authority under the Act but lacks authority to interpret § [621]." *Id.*

Moreover, the Commission has undertaken literally scores of rulemakings interpreting and applying various provisions of the 1992 Cable Competition Act as well video-related provisions of the 1996 Act, including numerous proceedings not specifically required by those Acts.[21] And there is nothing special about the "unreasonable refusal" requirement that makes Commission action inappropriate. The Commission has ample experience with crafting rules that implement statutory requirements like those in Section 621(a). The Commission routinely decides – both in the context of adjudications and rulemakings – the content of statutory provisions that hinge on whether particular actions are "reasonable" or "unreasonable."[22]

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[21] *See, e.g., Implementation of Section 11 of the Cable Television Consumer Protection and Competition Act of 1992*, CS Docket No. 98-82; *Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation*, MM Docket No. 93-215; *Implementation of Section 304 of the Telecommunications Act of 1996, Compatibility Between Cable Systems and Consumer Electronics Equipment*, PP Docket No. 00-67; *Closed Captioning and Video Description of Video Programming, Implementation of Section 305 of the Telecommunications Act of 1996, Video Programming Accessibility*, MM Docket No. 95-176; *Implementation of Section 203 of The Telecommunications Act of 1996 (Broadcast License Terms)*, MM Docket No. 96-90.

[22] *See, e.g., Implementation of Sections of the Cable Television Consumer Protection and Competition Act of 1992 Rate Regulation*, 8 FCC Rcd 5631, ¶ 1 (1993) (setting rules to ensure reasonable rates for basic cable service tier); *Star Lambert and Satellite Broadcasting and Communications Association of America*, 12 FCC Rcd 10455, ¶¶ 2-3 (1997) (determining that

Therefore, the Commission has ample authority to promulgate rules that interpret and give effect to Section 621(a)'s prohibition on LFA actions that amount to an "unreasonabl[e] refus[al] to award an additional competitive franchise," 47 U.S.C. § 541(a)(1), as well as other relevant provisions of the Cable Act.[23]

2. The Commission's Rules Are Preemptive and Binding.

Moreover, as the Commission recognized in the *Franchise NPRM*, when it adopts rules to interpret, construe and enforce the provisions of the Cable Act – including Section 621(a) – those rules are binding and preemptive. *Franchise NPRM* ¶ 15. There are several grounds for this preemptive authority.

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local ordinances violated Commission rules prohibiting unreasonable delays and unreasonable increases in costs for satellite providers); *Local Exchange Carriers' Rates, Terms, And Conditions For Expanded Interconnection Through Physical Collocation For Special Access And Switched Transport*, 12 FCC Rcd 18730, ¶ 2 (1997) ("Pursuant to Sections 201 through 205 of the Communications Act of 1934, as amended (Act), we are using the tariff review process to ensure that LECs provide interstate expanded interconnection service at rates, terms and conditions that are just, reasonable, and nondiscriminatory."); *IT&E Overseas, Inc., v. Micronesian Telecommunications Corporation,* 13 FCC Rcd 16058, ¶ 21 (1998) (evaluating claims of unreasonable preferences given in violation of § 202(a)).

[23] Moreover, the Commission's authority to interpret Section 621(a) is not diminished by the judicial review provision included in Section 621(a)(1), which separately authorizes applicants to seek redress for individual violations of federal law. That provision permits judicial review of a franchising decision, but only for an applicant "whose application for a second franchise has been *denied* by a final decision of the franchising authority." 47 U.S.C. § 541(a)(1)(emphasis added). Section 621(a), on the other hand, was carefully worded to prohibit an LFA's unreasonable refusal "to award" a competitive franchise, and thus was aimed at franchise abuses that stopped short of the ultimate denial of a franchise application. Thus, as the Commission has already recognized, this judicial review provision alone would not fully protect the interests animating Section 621(a) if it were construed in some cases to limit an applicant's recourse until the LFA issues a "final decision" on a franchise application. *See First Video Competition Report*, ¶ 56 n.127 (noting the concern that "the provision of Section 621 that allows an appeal only from a *final* decision of denial by a franchising authority potentially could be used by a franchising authority to delay or preclude a potential entrant from availing itself of the remedies in the Act," thus potentially "frustrat[ing] . . . the purpose of Section 621").

First, Section 636 expressly preempts State or local laws, as well as any cable franchise provisions, that are contrary to federal law. That provision states that "any provision of law of any State, political subdivision, or agency thereof, or franchising authority, or any provision of any franchise granted by such authority, which is inconsistent with this Act shall be deemed to be preempted and superseded." 47 U.S.C. § 556. This express preemptive authority does not permit states or municipalities to act in a manner inconsistent with the Commission's valid interpretations of the Cable Act. *See, e.g., Liberty Cablevision of Puerto Rico, Inc. v. Municipality of Caguas*, 417 F.3d 216 (1st Cir. 2005) (holding municipal franchise fee provisions preempted by Section 636 because inconsistent with Section 622); *City of Chicago v. AT&T Broadband, Inc.*, No. 02-C-7517, 2003 U.S. Dist. LEXIS 15453, at *6 (N.D. Ill. Sept. 4, 2003) (finding that Section 636 required preemption of local franchising agreements that would require payment of franchise fees on cable modem service, in light of Commission's determination that cable modem service was not a "cable service"); *MediaOne Group, Inc. v. AT&T Corp.*, 97 F. Supp.2d 712 (E.D. Va. 2000) (finding several provision of local ordinances preempted under Section 636 where contrary to various provisions of the Cable Act). Thus, State and local laws and franchising provisions that are contrary to federal law cannot stand.

Second, in addition to the express preemption offered by Section 636, the Supreme Court has long recognized that the Commission may, when acting within its delegated authority, preempt state and local laws addressing the regulation of cable services. As the Court explained, "if the FCC has resolved to pre-empt an area of cable television regulation and if this determination 'represents a reasonable accommodation of conflicting policies' that are within the agency's domain . . . we must conclude that all conflicting state regulations have been precluded." *Capital Cities Cable, Inc. v. Crisp*, 467 U.S. 691, 700 (1984) (internal citations omitted). In fact, more recently the Supreme Court has confirmed the Commission's broad preemptive authority to adopt any regulations necessary "'to carry out the provisions of' the Communications Act." *Iowa Utilities Bd.*, 525 U.S. at 378 (citing 47 U.S.C. § 201(b)); *see also Cellular Phone Taskforce v. FCC*, 205 F.3d 82, 96 (2d Cir. 2000) (noting that "FCC has broad preemption authority under the Telecommunications Act").

Consistent with this broad authority to effectuate Congress' purposes, the Commission possesses authority not only to give effect to the Cable Act's express provisions, but also to adopt binding interpretations that construe the meaning of any provisions that are ambiguous or when the statute is silent as to how they should be applied. *See, e.g., Chevron, U.S.A. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). For example, in the Commission's decision affirmed by the Seventh Circuit in *City of Chicago*, the Commission adopted an interpretation of the term "cable system" that clarified that the facilities in that case were not subject to franchising requirements. 199 F.3d at 427-28. The court then noted that the Commission's determinations are entitled to controlling authority when "the statutes [being interpreted] are silent or ambiguous" and the "agency interpretation is a reasonable one," and affirmed the Commission's construction of the terms "cable system" and "cable operator." *Id.* at 429-33. Therefore, the court found that the cities in that case were bound by the Commission's conclusions concerning the scope of their franchising power. *Id.*

<u>Third</u>, the Commission may preempt state or local law where, as here, "(1) the matter to be regulated has both interstate and intrastate aspects . . . (2) FCC preemption is necessary to protect a valid federal regulatory objective, . . . and (3) state regulation would 'negate[] the exercise by the FCC of its own lawful authority' because regulation of the interstate aspects of the matter cannot be 'unbundled' from regulation of the intrastate aspects." *PSC of Maryland v.*

FCC, 909 F.2d 1510, 1515 (D.C. Cir. 1990) (citations omitted)."[24] Preemption is proper on this basis whenever "separation [of interstate and intrastate aspects is] not practical." *PSC of Maryland*, 909 F.2d at 1516. Video services – particularly when offered over a national broadband network that supplies multiple services, including services like high-speed Internet access and voice-over-IP, that the Commission already has ruled are inseparably interstate services[25] – cannot be parceled meaningfully between interstate and intrastate components. And leaving unfettered discretion to LFAs to decide when to award or deny a competitive franchise to permit the offering of those services would surely frustrate federal video and broadband policies.

Fourth, and for similar reasons, the Commission has authority to preempt municipal authority that is inconsistent with Section 621(a)'s pro-competitive mandate, Section 706's pro-broadband policy, or with the other provisions of the Communications Act because such authority stands as "an obstacle to the accomplishment and execution of the full objectives of Congress" related to video competition and broadband deployment. *See Louisiana Public Service Commission v. FCC*, 476 U.S. 355, 369 (1986); *Hines v. Davidowitz*, 312 U.S. 52 (1941).

Finally, the Commission's authority to take the steps necessary to facilitate entry to the video market is bolstered by other federal laws and policies aimed at encouraging broadband deployment and investment. The Commission correctly recognized in the *Franchise NPRM* that video competition and broadband deployment go hand in hand. *Franchise NPRM* ¶ 11. In fact,

[24] *See also Vonage Holdings Corporation Petition for Declaratory Ruling Concerning and Order of the Minnesota Public Utilities Commission*, 19 FCC Rcd 22404, ¶ 19 (2004) ("*Vonage Order*").

[25] *GTE Telephone Operating Cos. GTOC Tariff No. 1, GTOC Transmittal No. 1148*, 13 FCC Rcd 22466, ¶¶ 26-29 (1998) (concluding impractical to separate the interstate and intrastate aspects of DSL services); *Vonage Order* ¶ 19 (same for voice-over-IP service).

the additional revenue stream from the sale of video services over these networks is an essential component of the business case justifying the huge investment required for the deployment of advanced broadband networks like FTTP. Given this connection between video competition and broadband deployment, the Commission must follow Section 706's instruction that it "encourage the deployment on a reasonable and timely basis of advanced telecommunications capabilities to all Americans" by, among other things, "remov[ing] barriers to infrastructure investment." Section 706 of the 1996 Act, Pub. L. No. 104-104, 110 Stat. 56; *see also* 47 U.S.C. § 157(a) ("the policy of the United States to encourage the provision new technologies and services to the public"). Because the local franchising regime jeopardizes investment in broadband networks by making it more difficult for a provider to realize an additional revenue stream from the network, Section 706's directive requires the Commission address and remove any illegitimate barriers created by the process.

Therefore, the Commission's tentative conclusion that it may preempt state or local laws that run contrary to federal law or policies is well founded, and the Commission can and should adopt binding and preemptive rules that effectuate Section 621(a)'s pro-competitive purposes.

II. The Commission Should Adopt Rules Addressing the Several Common Local Franchising Practices that Violate Section 621(a), Other Provisions of the Cable Act, and the First Amendment to the Constitution.

Since mid-2004, Verizon has initiated negotiations with well over 300 local franchising authorities seeking permission to offer video services over its FTTP network. O'Connell Decl. ¶ 8. Unlike traditional franchise negotiations with cable operators, these discussions have not been aimed at seeking permission for Verizon to build its physical network or to access public rights-of-way; Verizon already has that authority under federal and state telecommunications laws. Notwithstanding that the primary justification for the franchise requirement is entirely absent, Verizon has found the franchising process to be a long, hard slog. In some cases, the negotiating process has already stretched on for well over a year. *See id.* ¶ 9. And despite considerable effort and expense, only approximately two dozen franchises of Verizon's 51 current franchises were obtained through the typical franchising process (*i.e.,* not counting those made possible by the Texas legislation). *Id.* ¶ 8. To put that in perspective, Verizon estimates that it will need between 2,000 and 3,500 franchises to provide video services. *Id.* ¶ 10. At a rate of one franchise per day, it would take a decade or more to obtain that many franchises.

In Verizon's experience, some municipalities have recognized the unmitigated benefit that will flow to their residents as a result of this additional competitive choice and have quickly come to terms with Verizon on reasonable franchise agreements. For example, cities like Beaumont, California, and Keller, Texas, welcomed video competition and completed the franchising process relatively quickly. Likewise, the new statewide franchising process in Texas has made obtaining a franchise much more efficient in that State, while still protecting the local interests recognized by Congress.

In too many other cases, however, the local franchising process has delayed video choice by imposing demands on new entrants for the sorts of unlawful conditions, payments and goodies that were previously offered by the incumbents in exchange for their exclusive, monopoly franchises. And the cable incumbents who received those exclusive franchises have engaged in ground warfare to complicate the franchising process for Verizon in order to fend off competition. In fact, as the attached declaration of Marilyn O'Connell explains in greater detail, incumbents' efforts to avoid competition do not stop with the franchising process. For example, Cablevision's programming affiliate, Rainbow, has refused, for over a year, to comply with federal program access requirements in an attempt to deprive Verizon of valuable content – like regional sports networks. O'Connell Decl. ¶¶ 65-74.

As explained above, the Act's prohibition against "unreasonably refus[ing]" to award a competitive franchise is tantamount to an affirmative requirement that an LFA grant a competitive franchise application unless it has some "reasonable" basis for refusing.[26] With that in mind, Section 621(a), at a minimum, prohibits LFAs from conditioning a franchise on requirements that are otherwise impermissible under the Cable Act or the First Amendment.[27] Likewise, given Section 621(a)'s pro-competitive purpose, it could never be reasonable for an LFA to demand *more onerous* requirements on a new entrant than were required of the incumbent. Finally, as the Commission itself suggests in the *Franchise NPRM*, any

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[26] "Reasonable" is defined as "suitable under the circumstances; not immoderate or excessive, being synonymous with rational, honest, equitable, fair, suitable, moderate, tolerable." *Black's Law Dictionary* 1265 (6th ed. 1990); *see, e.g.*, *Cox Cable Communications, Inc. v. United States*, 992 F.2d 1178, 1181 (11th Cir. 1993) ("Given that the award of exclusive franchises is prohibited by the first clause of the Act, we believe that refusal to award an additional franchise solely because of the existence of an exclusive franchise with another party would be an 'unreasonable refusal' under the Act."). Therefore, what is "reasonable" in any given case varies based on the particular facts and circumstances involved. As noted above in the text, for a video provider who already has permission to deploy a network using the public rights-of-way, the demands that an LFA may *reasonably* make before the provider can offer a competitive video service over that network must be limited, given both the absence of the primary justification for requiring a franchise in the first place and the countervailing federal interest in encouraging video competition.

[27] As the comments set forth herein make clear, Verizon believes that the speed of competitive entry in cable markets will be enhanced significantly if the Commission expresses in forceful terms that a variety of practices currently engaged in by some LFAs are inconsistent with the pro-competitive mandate of the cable franchising provisions in the Communications Act. In advancing these comments, however, Verizon does not concede that FCC action in this docket is a prerequisite to judicial intervention or other methods of enforcement where such action is necessary to secure market access expeditiously. Particularly in light of the compelling First Amendment interests at stake, franchise applicants like Verizon should not be required to endure unlawful and unreasonable barriers to entry at the expense of constitutionally protected rights while cable incumbents continue to exploit their monopoly positions in cable markets nationwide.

determination of what an LFA "reasonably" may require as a condition of gaining entry into the video market must be informed by the underlying primary purpose of the franchising requirement – managing the public rights-of-way. *Franchise NPRM.* ¶ 22. Where those purposes are weak or absent – as in the case of a provider who *already* has authority to deploy its network and who seeks to provide a competitive service with no additional burden on the public rights-of-way – municipal franchising authority (and, for First Amendment purposes, the relevant governmental interest) is at its lowest ebb.[28]

As discussed below, even small steps would go far in addressing many of the common abuses that plague the franchising process.

A. The Delay Commonly Associated with Obtaining a Competitive Franchise Frustrates the Purposes of Section 621(a), and the Commission Should Impose Reasonable Time Limits on the Franchising Process.

One of the biggest problems with the current franchise regime is that the process simply takes too long. The process – including application, review, negotiation, and approvals – routinely takes many months, and can take more than a year. *See* O'Connell Decl. ¶ 9; Hazlett Decl. ¶¶ 9-10. The problem of delay results in part from factors such as inertia, arcane or lengthy application procedures, bureaucracy or, in some cases, inattentiveness or unresponsiveness by the LFA. *See* O'Connell Decl. ¶ 16. In other cases, delay is used by municipalities as a negotiating tactic in an effort to force Verizon to agree to unreasonable, and

[28] In other contexts, the cable incumbents have recognized this when they have argued against duplicative local rights-of-way regulations of their own facilities. In their words, it would "make[] no sense when . . . new services can be offered simply by changing the pattern of signaling sent over an existing physical transmission facility, *without imposing any additional burden on rights-of-way*." Comments of NCTA, *IP-Enabled Services*, WC Docket 04-36 at 21(filed May 28, 2004) (emphasis added); *see also* Reply Comments of Comcast Corporation, *Internet Over Cable Declaratory Ruling*, CS Docket 02-52 at 23 (filed Aug. 6, 2002) ("[T]he addition of cable Internet service does not impose any additional burdens on the rights-of-way [and therefore need not be subjected to an additional franchise requirement].").

often unlawful, conditions or concessions. *See id.* And delay is nearly always increased as a result of the efforts of incumbent cable operators to forestall the onset of video competition using any means available. Section 621(a), by its very terms, was intended to prohibit unreasonable delay in the franchising process. Accordingly, the Commission should conclude – consistent with other provisions of the Cable Act – that LFAs must accept or deny a franchise application within four months of negotiations being initiated by a competitive provider, and that any procedures or practices that prevent such timely review are unreasonable and preempted.

1. Delay Is Rampant in the Franchising Process.

Verizon's experience illustrates well the delay endemic in the franchising process. After starting the process of seeking video franchises in mid-2004, Verizon has sought franchises from well over 300 LFAs, yet it has so far obtained only 51 – a significant portion of which were obtained in Texas after that State adopted a streamlined franchising process. O'Connell Decl. ¶ 8. There is even greater cause for concern going forward as Verizon continues to ramp up deployment, thus triggering the need to obtain hundreds or even thousands of additional franchises. *See id.* ¶ 10. Of the more than 300 municipalities with whom Verizon is currently negotiating, more than half of the negotiations have dragged on for more than six months, and some have already been going on for more than one year. *See id.*

Examples of unreasonable delay abound. In one community in Virginia, Verizon initiated negotiations in July 2004. *See id.* ¶ 18. By November 2004, Verizon thought it had negotiated a final franchise agreement with the town attorney, establishing a timeline for notice, commission and council review, with a final vote slated for February 2005. *Id.* But then the town council only referred the agreement to the town cable commission, which demanded significant changes to the negotiated agreement and hired an outside attorney. *Id.* The new attorney's review resulted in re-starting negotiations virtually from scratch. *Id.* Verizon is now dealing with a third attorney who has informed Verizon that the town is not sure it is "interested" in having a second cable franchise. *Id.*

Similarly, the county staff for one county in Florida required Verizon to file several versions of its applications, demanding additional information each time before they would submit Verizon's application to the County Board for approval *to initiate* negotiations. O'Connell Decl. ¶ 21. Verizon's original application was filed in November 2004, and the County Board did not authorize negotiations until a year later. *Id.* As a result, substantive negotiations with staff have only recently begun. *Id.*

After Verizon approached one community in California in November 2004, Verizon was told that it would be required simultaneously to negotiate with three other nearby cities. O'Connell Decl. ¶ 20. Verizon eventually acceded to this request, but did not receive the cities' initial list of demands for over a year. *Id.* On January 11, 2006, Verizon heard from the cities' counsel that they had rejected Verizon's proposed agreement and demanded Verizon pay a $25,000 application fee and use the final agreement Verizon had negotiated with one Virginia jurisdiction as the *starting point* for negotiations. *Id.*

In many cases, these delays are caused, or at least increased, by disagreements with an LFA over the terms of a franchise agreement. As discussed below, some LFAs make outrageous demands on new entrants, thereby requiring protracted delays and increasing the cost of entry (assuming the provider decides to go ahead at all). In other cases, however, the delay in the franchising process is created by procedural hurdles, such as statutory formalities that impose waiting periods before a franchise may be granted or require multiple layers of review. Massachusetts is one example where franchising procedures contain procedural hurdles and public notice periods that not only inhibit negotiations but also make it impossible to obtain a franchise in less than six months *even if the regulators and all parties agree on all the terms of the franchise*. And in some states, like New York and New Jersey, a franchise must be approved at both the local and state level (after being negotiated with staff), thus resulting in additional delay. *See* O'Connell Decl. ¶ 13.

In addition to delay attributable to LFA actions, the franchising process also permits self-interested third parties – such as incumbent cable operators and outside cable consultants – to interfere in the process in an effort to subject Verizon to further delay and expense. In most cases, they do just that. *See id.* ¶¶ 58-63. Incumbents in particular have an obvious self-interest in imposing maximum delay and expense on Verizon in order to delay competition and improve their own competitive position by raising their rivals' costs even after eventual entry.

Litigation is one preferred tactic. Several cable operators have both threatened and filed lawsuits against municipalities to stop them from awarding franchises to Verizon or to intimidate those LFAs who may do so. *See id.* ¶¶ 59-60. For example, after the Village of Massapequa Park became the first LFA in New York to approve the issuance of a cable franchise to Verizon, Cablevision – the incumbent cable provider in Massapequa Park – brought suit against the Village and Verizon alleging that, in approving Verizon's franchise, the Village had violated the state Open Meetings Law. *Id.* ¶ 59. In a transparent attempt to intimidate the Village officials, Cablevision also filed an order to show cause why it should not be permitted to depose the mayor and the Village trustees. *Id.*

And this is not an isolated incident; cable operators have threatened litigation with several other municipalities, often threatening to file suit over alleged violations of the so-called "level playing field" requirements. *Id.* ¶ 60. Charter has made such threats to LFAs in Texas, and Adelphia has made similar threats in Virginia. *Id.* Other cable operators have sent municipalities threatening materials (often before Verizon even submits a franchise application) warning them of a battle ahead. *Id.* These actions already appear to be having a chilling effect on some LFAs, who have expressed concern about commencing the franchise process out of fear that they may be dragged into litigation.[29] O'Connell Decl. ¶ 60. Moreover, these tactics have led several LFAs to request that Verizon agree to indemnify them if incumbents bring suit. *Id.*

Incumbents also have tried other approaches to cause delay in the franchising process. For example, several cable operators have slowed the franchise process by demanding the opportunity to review Verizon's proprietary information, including actual dates of construction, services to be delivered, maps of service areas, and pricing information. *Id.* ¶ 62. In other cases, they have simply raised baseless objections, generally at the last possible minute, in an effort to force delay. *Id.* For example, in Howard County, Maryland, where Verizon recently obtained a franchise, the local incumbent made an intense eleventh-hour push to delay the council from approving the franchise until Verizon agreed to a long list of additional conditions. *Id.* ¶ 63.

The incumbent cable providers are not the only ones who profit from stringing out the franchising process. LFAs often hire outside consultants to help negotiate on their behalf, and it is in these consultants' economic interest to force protracted negotiations, given that they are typically paid by the hour. *See id.* ¶ 56. Moreover, it is often the franchise applicant – that is, Verizon – who is forced to pay the consultant fees, which provides even greater incentives for

[29] *See* D. Searcey, *Spotty Reception: As Verizon Enters Cable Business, It Faces Local Static*, Wall St. J., Oct. 28, 2005 at A1 ("[Tampa] City officials began worrying about lawsuits from the cable company. They demanded Verizon include a clause in its franchise agreeing to pick up the tab for any lawsuits related to the deal. Verizon refused.").

the consultant to drive up fees as high as possible. *See id.* These consultants are responsible for some of the most blatantly unlawful demands during franchise negotiations. *See id.* ¶¶ 57-58.

2. The Commission Should Impose Reasonable Time Limits on the Franchising Process.

Section 621(a), on its face, prohibits delay in franchising decisions. Congress' very choice of words – "unreasonably refuse to award" – requires that the franchising process move forward at a reasonable pace. Notably, this provision does *not* apply only when an LFA affirmatively, or even constructively, *denies* a competitive franchise. On the contrary, it also applies when a franchising authority unreasonably fails to grant a competitive franchise, as it might do through simple inaction or delay. And for good reason. One of the key concerns underlying the provision is that franchising authorities could simply string out the process and deter entry by not acting in a reasonable period of time on a franchise application. So the provision applies fully when a franchising authority unreasonably withholds action, or simply fails to act within a reasonable period of time. Perpetual delays – or delays prompted by incumbents' stall tactics or LFAs' insistence on unlawful franchise conditions – frustrate both the express terms and the purposes of Section 621(a). Moreover, whether because the financial calculus changes or simply the length of the delay itself, unreasonable delay can result in no competitive deployment at all to many customers. *See* Hazlett Decl. ¶ 11.

The First Amendment also mandates that LFAs be required to issue a prompt decision. Where the exercise of free speech rights is dependent on the issuance of a permit, any "undue delay" in the permitting process unconstitutionally suppresses protected speech. *City of Littleton*, 541 U.S. at 782 (quoting *FW/PBS, Inc. v. City of Dallas*, 493 U.S. 215, 228 (1990) (plurality opinion) (internal quotation marks omitted)). The First Amendment requires licensing authorities to issue permits in any individual case within a reasonable period of time. *See City of*

Littleton, 541 U.S. at 780-81; *Church of the American Knights of the Ku Klux Klan v. City of Gary*, 334 F.3d 676, 682 (7th Cir. 2003).

The record in this proceeding demonstrates that Commission action is needed to ensure that franchises are granted within a reasonable period of time. A national, uniform policy establishing a reasonable and specific time deadline within which LFAs must act will further the purposes of Section 621(a) while protecting cable operators from "delay-induced First Amendment harm," *City of Littleton*, 541 U.S. at 782, and ensuring that the public's access to varied sources of information is not unduly postponed or denied.

As the Commission adopts rules to prevent delay, other parts of the Cable Act indicate Congress' view on how quickly an LFA should be able to act, all of which point to four months as a reasonable deadline for LFA action. For example, Section 626(c)(1) – the Act's provision addressing the renewal process for franchises – reveals what Congress considered "reasonable" by establishing that a reasonable period of time for an LFA to grant a renewal application filed by an incumbent cable operator is four months. 47 U.S.C. § 546(c)(1). Similarly, Section 625, which permits an incumbent to request a modification in its franchise agreement from an LFA, directs the LFA to issue a "final decision . . . in a public proceeding . . . within 120 days after receipt of such request by the franchising authority, unless such 120-day period is extended by mutual agreement of the cable operator and the franchising authority." 47 U.S.C. § 545(a)(2). Finally, under Section 617, an LFA has 120 days "to act upon any request for approval" of a sale or transfer of a franchise. 47 U.S.C. § 537. These provisions provide an apt benchmark for the maximum permissible time limit for action on a franchise application by a would-be competitive provider. If anything, the award of a competitive franchise should be treated with *more* expedition than the modification, renewal, or sale of an incumbent franchise, because the latter do not restrain competition or prevent protected speech.

And Verizon's experience bears out that four months is more than adequate for an LFA to review an application. Texas has found that the franchising process can be handled in 17 days, and some other LFAs with whom Verizon has individually negotiated franchises have granted a franchise in as little as a month. *See* O'Connell Decl., Exh. 1. Thus, there is no necessity for the franchising process to be a protracted one.[30]

Moreover, as explained above, both Section 621(a)(4) and the First Amendment narrowly limit the factors that can be considered in determining whether to grant a competing franchise in any event, thus obviating the need for a protracted review process. Therefore, the Commission should adopt a four-month time period as the maximum time limit for judging a franchise application.

A tightly prescribed timeframe is especially appropriate for a provider like Verizon who is already authorized to construct and operate the network over which its video services will be transmitted, and a delay in excess of four months should be deemed per se unreasonable with respect to such a provider. The LFA's interest in managing the public rights-of-way – the principal rationale for franchise requirements – is lacking for such providers.[31] Therefore, as the Commission suggested in the *Franchise NPRM,* the reasonableness of an LFA's actions should be subject to a heightened scrutiny in this context. *Franchise NPRM* ¶ 22.

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[30] Indeed, even NATOA's representative recently told the Commission at its open agenda meeting that she believed that the franchising process should take no more than six months.

[31] *See National Cable Television Ass'n v. FCC*, 33 F.3d 66, 73 (D.C. Cir. 1994) (noting that "use of public rights of way . . . provide[s] a key justification for the cable franchise requirement").

In order to give effect to Congress' view of what constitutes a reasonable amount of time, the Commission also should establish specific guidelines concerning what should happen during this four-month period in order to ensure that the process works efficiently as Section 621(a) requires. First, the Commission should require LFAs to initiate negotiations within 30 days of a request to do so by a competitive provider. This is necessary to address the common problem that Verizon has experienced with LFAs that simply fail to respond in a meaningful way after Verizon has expressed interest in offering competitive video services in an area. Any procedural requirements to the contrary should be deemed per se unreasonable under Section 621(a).

Second, the Commission should recognize that if negotiations fail to yield a proposed franchise within 90 days of the original request to negotiate, the applicant should be permitted to submit a proposed franchise directly to an LFA's governing body for action. Third, a governing body should then be permitted 30 days to vote on the submission, unless the applicant agrees to an extension, and the Commission should recognize that a failure to act constitutes a grant of a franchise on the terms of the proposal submitted. Again, this would prevent unreasonable and perpetual delay by requiring an up or down vote within a reasonable period of time. Finally, the Commission should recognize that any procedures that would lead to a delay of longer than four months are per se unreasonable. For example, multiple layers of review of a franchise agreement – as is currently the case in some jurisdictions – should only be permissible if the added procedural hurdles do not result in a protracted process that exceeds the four-month timeframe.

With these specific rules to prevent unreasonable delay and keep the franchising process moving, the Commission would go far towards giving effect to the express terms and furthering the goals of Section 621(a).

B. Unreasonable Build-Out Requirements Should Be Preempted.

Unreasonable and anti-competitive build-out requirements – often at the urging of incumbent providers – are another significant barrier to competitive entry. In particular, citing the so-called "level playing field" requirement discussed below, many incumbents maintain that a new entrant must build out and provide cable service to all households within the *incumbent's* service area rather than defining and building out its own service area. The Commission must reject that position as inconsistent with Section 621(a), and should confirm that a new entrant may define its own franchise area, as long as it does so in a manner that is reasonable and consistent with the Act.

As an initial matter, it is worth noting that the cable incumbents successfully avoided build-out or universal service obligation when they began to offer telephone services. For example, in testimony to the Senate in 1994, the president of Comcast stated: "you should not require that every provider must make service available to every household in a state or service region. That is simply unrealistic to expect of new entrants in this market, and it is simply unnecessary."[32] Likewise, NCTA's president agreed then that "no new entrant could comply with a requirement to offer service immediately to all potential subscribers."[33]

The same is certainly true today for new entrants who seek to enter the video market. As a new entrant who will face stiff competition everywhere that it offers video service, Verizon decides where to upgrade to FTTP based on what makes economic sense given various

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[32] *The Communications Act of 1994: Hearing on S. 1822 Before the Senate Commerce Committee* (May 18, 1994) (statement of Brian Roberts, President, Comcast Corporation on Local Loop Competition and Universal Service Issues).

[33] *The Communications Act of 1994: Hearing on S. 1822 Before the Senate Commerce Committee* (May 4, 1994) (statement of Decker Anstrom President and CEO National Cable Television Association).

technological and marketplace dynamics such as consumer demand, competition from cable, the state of its own network, or other local factors that affect the cost of deployment. *See* O'Connell Decl. ¶ 23. Where Verizon upgrades to FTTP, however, it typically builds out an entire wire center and makes FTTP available to customers served by that wire center, without regard to political boundaries or neighborhood. *See id.* On the other hand, with the exception of a limited number of "greenfield" situations, Verizon generally does not deploy FTTP in areas outside of its local telephone service area where it has no facilities and deployment would be uneconomical. *See id.* LFAs, often at the urging of incumbent cable operators, routinely require Verizon to go beyond this sensible approach and to build-out and serve the *incumbent's* entire franchise area or even the LFA's entire jurisdiction – and not the franchise area that Verizon proposes. *Id.* ¶¶ 24-27.

Dictating a new entrant's build-out in this manner would, in many cases, risk preventing entirely a competitive provider's ability to offer video competition in an area. *See* Hazlett Decl. ¶¶ 13-17. And these problems are compounded by the fact that many wire centers serve customers in multiple political subdivisions. If each of those communities sought to impose similar build-out obligations, the costs could increase exponentially, making deployment uneconomic in such areas. *See* O'Connell Decl. ¶ 24.

All of these problems are amplified when an LFA would force a provider like Verizon to build facilities outside of its traditional telephone service area. In fact, even the president of NCTA recently conceded in response to questioning at the Commission's open meeting that it would be reasonable not to require traditional telephone companies to build out and offer video service outside of their traditional telephone service areas.

1. Some LFAs Demand Unreasonable Build-Out by New Entrants.

Despite Verizon's approach of building out on a wire center basis and serving customers throughout the area served by the wire center, some LFAs have demanded that Verizon and other new entrants do more to obtain a franchise. For example, some communities try to dictate the timing and scope of Verizon's video deployment. *See* O'Connell Decl. ¶ 24-27. Other LFAs even go so far as to demand that Verizon deploy FTTP throughout their jurisdiction, even when parts of the jurisdiction fall outside of Verizon's telephone service area and are areas where Verizon does not have, or plan to deploy, facilities. The result of such unreasonable demands would be to prevent a competitive choice for *any* households in an area when such service is not possible for *all* households.

For example, in California, some (but not all) LFAs have taken the position that California's "wire and serve" statute requires Verizon to build out to the incumbent's entire franchise area, despite the fact that Verizon's telephone service area does not cover much of the same area. O'Connell Decl. ¶ 27. One consortium of California communities, who insist that Verizon negotiate with them collectively, have demanded that Verizon serve all of the households in each community before it may serve any households in any of the communities. And this consortium makes this demand even though large parts of these communities fall outside of Verizon's traditional telephone service area. *Id.* ¶ 20. (More recently, this group has indicated that they may back off of this extreme position on build-out, but only if Verizon will accede to other unacceptable demands). *Id.*

Similarly, in one Texas community (prior to the recent Texas legislation), the LFA demanded that Verizon serve the entire franchise territory without exception. *Id.* ¶ 26. Although

Verizon agreed to serve approximately 97-98 percent of the town, the LFA rejected this offer and terminated negotiations with Verizon for over a year. *Id.*

2. The Cable Act Permits New Entrants to Define Their Own Franchise Areas.

As discussed above, if a provider were forced to build out to serve the *incumbent's* franchise area or an LFA's jurisdictional boundaries, in many cases it may be uneconomical for the provider to enter the cable market at all, thus denying to all households in the franchising jurisdiction the benefits of competition. *See* Hazlett Decl. ¶ 17. This result is directly contrary to the pro-competitive purposes of the Cable Act. As explained throughout these comments, Congress sought in the 1992 amendments to the Act to open cable markets to the benefits of competition. As part of its effort to achieve this goal, it barred LFAs from imposing conditions – like unreasonable build-out requirements that would prevent competitive entry – tantamount to an unreasonable refusal to award a competitive franchise. To effectuate Congress's pro-competitive purpose, the Commission should confirm that new entrants may define their own franchise areas, provided that such areas are reasonable and do not otherwise violate the Act.

Permitting a new entrant to define its own area would be the most effective way of ensuring, consistent with Section 621(a), that build-out requirements do not unreasonably prevent competitive entry. As discussed more below, the Act does not expressly define "franchise area," although it does provide ample indication that such an area does not have to be the same for each provider or be coextensive with an LFA's jurisdiction. Therefore, as long as the new entrant's definition of its franchise area is reasonable and otherwise consistent with the Act, then LFAs should be required accept that definition. And where an entrant promises to build out the entirety of a wire center (or group of wire centers), that approach should be considered presumptively reasonable.

As explained above, Verizon typically upgrades to FTTP throughout a wire center, without respect to municipal boundaries or neighborhood, when it converts that wire center to FTTP. Thus, even when the areas served by such a wire center do not neatly correspond to the incumbent's franchise area or to the boundaries of the one or more LFAs served by the wire center, it is surely "reasonable" for Verizon or another entrant to define its franchise area with reference to the locations served by that wire center. Likewise, it would be *unreasonable* and in violation of Section 621(a) for an LFA to instead impose other artificial boundaries that make no sense in light of this network architecture. Such a requirement would serve no legitimate purpose and would deny the customers served by that center a competitive choice for video.

The arguments sometimes made for requiring build-out beyond a new entrant's proposed franchise area cannot stand up to Section 621(a)'s pro-competitive mandate. In seeking to require Verizon to build its network to correspond identically to the incumbent's franchise area or to cover the entire LFA jurisdiction, incumbents and LFAs primarily have relied on two provisions of the Cable Act, neither of which supports their position.

First, Section 621(a)(3) allows an LFA to "assure that access to cable service is not denied to any group of potential residential cable subscribers because of the income of the residents of the local area in which such group resides." 47 U.S.C. § 541(a)(3). This provision, however, does not require universal build-out within a jurisdiction. *See ACLU v. FCC*, 823 F.2d 1554, 1580 (D.C. Cir. 1987) ("The statute on its face prohibits discrimination on the basis of income; it manifestly does not require universal service."). Nor does it require competitive entrants to provide services everywhere the incumbent does. As the House Energy and Commerce Committee explained, subsection (a)(3) would not "prohibit a franchising authority from issuing different franchises for different geographic areas within its jurisdiction." H.R.

Rep. No. 98-934, at 59 (1984). Similarly, the Commission has recognized (both in the *Franchise NRPM* and in previous proceedings) that build-out requirements and the prohibition on economic discrimination present distinct issues. *See Franchise NPRM* ¶ 23; *Implementation of the Provisions of the Cable Communications Policy Act of 1984*, 58 Rad. Reg. 2d (P&F) 1, ¶ 82 (1985) (noting that "redlining" prohibition "does not mandate that the franchising authority require the complete wiring of the franchise area in those circumstances where such an exclusion is not based on the income status of the residents in the unwired areas."). Therefore, this provision does not prevent a provider like Verizon from defining its own reasonable franchise area so long as it does so consistent with Section 621(a)(3).

Second, Section 621(a)(4)(A) likewise does not authorize an LFA to require a competitive entrant to build out beyond the franchise area that it selects. Section 621(a)(4)(A)'s operative language – "a franchising authority . . . shall allow the applicant's cable system a reasonable period of time to become capable of providing cable service to all households in the franchise area" – does not speak to what an *operator* must do with respect to its territorial boundaries but rather to what an *LFA may not do* (that is, insist on unreasonably short time deadlines). 47 U.S.C. § 541(a)(4)(A). Indeed, when considering this provision, Congress explicitly rejected an approach that would have imposed affirmative obligations on cable providers. The House version of the bill provided that an LFA's "refusal to award a franchise shall not be unreasonable if, for example, such refusal is on the ground . . . of inadequate assurance that the cable operator will, within a reasonable period of time, provide universal service throughout the entire franchise area under the jurisdiction of the franchising authority." *House Report* at 148. Congress declined to adopt this language, and in so doing, made clear that it did not intend to require competitive operators to provide service throughout an LFA's jurisdictional territory.

Moreover, Section 621(a)(4)(A)'s reference to "all households in the franchise area" provides no warrant for an LFA to demand that competitive entrants provide service throughout its jurisdiction. Although the statute does not expressly define the term "franchise area," past Commission precedent and textual indicators demonstrate that the phrase does not refer to the entire LFA jurisdiction. As far back as its *1972 Cable Order*, the Commission recognized the distinction between an LFA's jurisdictional boundaries and the boundaries of franchise areas within that jurisdiction. *1972 Cable Order*, 36 FCC 2d. 143 at ¶ 177 (1972). In that order, the Commission noted that LFAs should determine "how best to parcel large urban areas into cable districts." *Id.* And the Commission noted that "[t]here are a variety of ways to divide up communities" when an LFA decides "the delineation of franchise areas." *Id.* ¶ 180. Nowhere in that order did the Commission suggest that the same "franchise area" should be assigned to all providers, or that a franchise area must be coterminous with the LFA's jurisdictional boundaries.

Congress too recognized this distinction. While Section 621(a)(4)(A) speaks of a "franchise area," other provisions of the Act refer to a local franchising authority's "jurisdiction." *See, e.g.,* 47 U.S.C. § 543(a). In other words, when Congress wanted to refer to an LFA's territorial jurisdiction, it knew how to do so. Congress, moreover, deliberately rejected legislative language that could have implied that operators had to provide service throughout the jurisdiction of the franchising entity. Whereas the enacted language speaks only of "the franchise area," the House bill described the relevant territory as "the entire franchise area under the jurisdiction of the franchising authority." *House Report*, at 148. In rejecting this approach, Congress demonstrated that "franchise area" means something different than the "jurisdiction of the franchising authority." Therefore, particularly in light of Section 621(a), the statute supports the position that a competitive provider should be permitted to define its own franchise area.

Finally, Congress also required that a new entrant be permitted a reasonable period of time for build-out, even within the franchise area that the provider designates. Section 621(a)(4)(A) states that an LFA "shall allow the applicant's cable system a reasonable period of time to become capable of providing cable service to all households in the franchise area." 47 U.S.C. § 541(a)(4)(A). This provision, read in conjunction with the pro-competitive purposes of the Act, means that new entrants must be given at least as much time as the incumbents had to build out their designated franchise area. *See Senate Report*, at 91 ("For purposes of this section, a reasonable period of time would include a period of time comparable to that taken for the incumbent cable operator to construct its cable system for a comparably sized franchise area."); Statement of Sen. Gorton in Support of the Conference Report on S. 12, 138 Cong. Rec. S14222, at S14248 (Sept. 21, 1992) (noting that Section 621(a)(4) would encourage competition by "assuring that adequate time is given the new franchisee to build a system."). As the Commission has previously recognized, requiring build-out throughout a jurisdiction in an expedited manner harms both new entrants and consumers. Such a requirement is both unnecessary – in light of the incentives to respond to the "broad-based demand for cable services" – and "ill-advised" – in light of the benefits to consumers even from localized competition. *FCC Video Recommendation Report* at ¶ 139 and n.198. Accordingly, requiring a competitive operator to build out more quickly than did the incumbent is inconsistent with Section 621(a) and per se unreasonable.

3. The First Amendment Limits the Build-Out That May Be Required.

The First Amendment independently demands this circumscribed view of the build-out requirements an LFA may impose on a new entrant. Three separate First Amendment doctrines are at play here.

First, when interpreting and applying the term "franchise area," the Commission must consider that the First Amendment does not permit governments to impose overly broad burdens on speech, even if such burdens are content-neutral. Regulations burdening speech must "further[] an important or substantial governmental interest; . . . the governmental interest [must be] unrelated to the suppression of free expression; and . . . the incidental restriction on alleged First Amendment freedoms [must be] no greater than is essential to the furtherance of that interest." *Turner I*, 512 U.S. at 662 (quoting *United States v. O'Brien*, 391 U.S. 367, 377 (1968) (internal quotation marks omitted)). Onerous build-out mandates fail this intermediate scrutiny test because they impose burdens that are wholly disproportionate to the benefits they confer.

As discussed above, requiring a competitive entrant fully to overbuild the incumbent's franchise area or the LFA jurisdiction would seriously interfere with its free speech rights, and may in fact keep an entrant from offering service at all – and thus engaging in protected speech – in some areas. At the same time, build-out requirements do little to advance local franchisors' interest in ensuring broad access to cable services and are therefore not narrowly tailored to governmental objectives. In the areas where a new entrant seeks a competitive franchise, an incumbent operator already provides cable service through a network it developed free from market competition. Moreover, to the extent that build-out requirements prevent a competitive provider from entering the market altogether, such demands thwart, rather than advance, valid governmental objectives.

Nor can any proffered interest in preventing the risk that households would have no access to cable service justify the kinds of build-out requirements new entrants face. To sustain such requirements, the government bears the burden of demonstrating that there is a genuine risk that a substantial number of prospective consumers would not have access to any form of cable in the absence of government regulation. In light of the newly emerging competitive cable market, as well as significant competition in access to video programming through myriad means, including internet and satellite sources, the government cannot sustain this burden of showing that the "recited harm[]" it seeks to cure is anything more than "conjectur[e]" or speculation.[34] Given that most incumbent providers have already built out their systems to reach large geographic footprints, it is difficult to imagine, and would be nearly impossible for the government to prove, that incumbent providers would abandon any of their existing customer base. Because the government cannot meet its burden to demonstrate an important and substantial government interest based on current fact in lieu of outdated speculation, any such build-out requirements cannot withstand constitutional scrutiny.[35]

In addition, the government cannot meet its burden to demonstrate that build-out requirements imposed on new entrant cable providers "w[ould] in fact alleviate the[alleged] harms in a direct and material way."[36] Instead, government forced build-out requirements for new entrants would have the *perverse effect* of hindering further deployment of competitive

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[34] *Turner I*, 512 U.S. at 664; *accord Edenfield v. Fane*, 507 U.S. 761, 770 (1993) (state's speech ban could not be justified by "mere speculation or conjecture").

[35] Moreover, even if the government could demonstrate a substantial interest in forcing *a* cable provider to provide service to anyone who desires it within a particular geographic area, it certainly cannot demonstrate a particular interest in forcing *new entrants* to meet all of these needs, where incumbent providers are already equipped to, and do, provide service throughout the geographic territories at issue.

[36] *Turner Broadcasting Systems v. FCC*, 520 U.S. 180, 189 (1997) ("*Turner II*").

cable services or impeding investment in more diverse content. In this way, forced build-out requirements would be quite effective at preserving cable monopolies and wholly ineffective at opening up the cable market to ensure a greater diversity of programming and service.

Likewise, the government cannot surmount the final intermediate scrutiny hurdle of demonstrating that forced build-out requirements would "not burden substantially more speech than necessary to further th[e alleged] interests."[37] The most obvious alternative means of achieving a similar result – widely available access to video programming – in 2006 is to resort to the free market to allow video programming competitors to meet the needs of would-be consumers throughout given geographic areas. The government has a constitutional obligation to consider such other means that impose fewer burdens on speech. Finally, even if *maintaining* geographic access requirements for incumbent providers could be justified as necessary to further the government's purported interest, there is no such justification for imposing those same build-out requirements on new entrants, where such a barrier to, or substantial cost of, entry would undoubtedly burden more speech than is necessary to meet the goal of universal access.

Second, build-out requirements run afoul of the First Amendment by dictating the audience to whom a cable operator must speak. Part and parcel of the First Amendment right to speak is the would-be speaker's right *not* to speak or publish certain content.[38] As one federal

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[37] *Turner II*, 520 U.S. at 189 (citation omitted).

[38] *See, e.g.*, *Pacific Gas & Electric Company v. Public Utilities Commission of California*, 475 U.S. 1, 11 (1986) ("The essential thrust of the First Amendment is to prohibit improper restraints on the *voluntary* public expression of ideas . . . . There is necessarily . . . a concomitant freedom *not* to speak publicly, one which serves the same ultimate end as freedom of speech in its affirmative aspect." (internal quotation marks and citations omitted)); *cf. Meyer v. Grant*, 486 U.S. 414, 424 (1988) ("The First Amendment protects [the speaker's] right not only to advocate their cause but also to select what they believe to be the most effective means for so doing.").

court explained in *Century Federal, Inc. v. City of Palo Alto*,[39] this right to tailor one's speech and publishing to a geographically limited audience is beyond question:

> Could the Cities require a newspaper, movie house, or bookstore to deliver to or be located in a particular geographic area of the community on the ground that it is in the best first amendment interests of the residents in that area? Surely, the answer is no. The First Amendment protects both the right to speak freely and the right to refrain from speaking at all.[40]

Particularly in light of the explosion in competing methods of video delivery to consumers since *City of Palo Alto* was decided 20 years ago, a government requirement that purports to compel a cable operator to redefine its audience and expand its publication to a geographic area where it does not wish to publish is subject to rigorous First Amendment scrutiny.[41]

In fact, even in the context of commercial speech, with its lesser degree of protection than the speech at issue here, compelled speech has been found to impermissibly burden a speaker's First Amendment rights. *See United States v. United Foods*, 533 U.S. 405 (2001) (striking down mandatory contribution to industry-wide advertising as compelled speech). And these protections extend to the right of the speaker to choose to whom it will or will not communicate. For example, in overturning Commission rules that would restrict a telephone company from using CPNI to engage in targeted marketing of its customers, the Tenth Circuit held that "a restriction on speech tailored to a particular audience, 'targeted speech,'" was an impermissible restriction on the carrier's First Amendment rights. *US West v. FCC*, 182 F.3d 1224, 1232 (10th Cir. 1999); *see also Verizon Northwest v. Showalter*, 282 F.Supp.2d 1187, 1191 (W.D. Wa.

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[39] 710 F. Supp. 1552 (N.D. Cal. 1987).

[40] *Id.* at 1556 (citations omitted).

[41] *Id.* at 1555-56 (subjecting forced cable access and build-out requirements to strict scrutiny under the First Amendment).

2003). Thus, regardless of the level of scrutiny applied, build-out requirements impose an impermissible burden on the First Amendment rights of a would-be cable operator.

Third, as discussed above, the prior restraints doctrine requires that well-defined, objective standards confine franchisors' discretion. In the context of build-out requirements, this means that federal law should be read as prescribing clear and objective criteria to constrain LFAs' authority to define operators' franchise areas at will. As discussed above, Section 621(a)(4)(A) requires LFAs to give cable operators "a reasonable period of time to become capable of providing cable service to all households in the franchise area," but it does not define a "franchise area." Ensuring that a new entrant is permitted to define a franchise area so long as it is consistent with other statutory requirements would ensure that LFAs do not have the type of boundless discretion that is anathema to the First Amendment.

In light of the constitutional defects of onerous build-out requirements, the Commission must read "franchise area" as including only the area in which the cable applicant has chosen to provide service.

4. At a Minimum, Relevant Differences Between Incumbents and New Entrants Must Be Considered.

At a minimum, the Commission should make clear that LFAs may not overly burden competitive entrants when considering the boundaries of their service region. This means requiring LFAs to take into account: (1) the fact that the new entrant will face ubiquitous competition, thus making deployment in some areas uneconomical, and (2) relevant differences in network architecture between the new entrant and the incumbent, including the new entrant's service area for non-cable services.

First, an LFA would erect an unreasonable barrier to entry if it did not take into account relevant differences between providers, including in particular the competitive position of the provider.[42] As discussed below in the context of so-called "level playing field" requirements, the Commission has long recognized that new entrants, by definition, are differently situated from incumbents and should not be subject to identical obligations to an incumbent. For example, the Commission previously recognized that the application of build-out requirements to competitive telephone providers would prevent competitive entry, and the Commission expressly preempted such requirements when a state tried to impose them.[43] The Commission recognized then that build out requirements would "impose a financial burden that has the effect of prohibiting certain entities from providing telecommunications services." *Public Utility Commission of Texas,* ¶ 13. The Commission also concluded that imposing build out on a new entrant would be "prohibitively expensive" and would "impact the threshold question of whether a potential competitor will enter the local exchange market at all." *Id.* ¶¶ 78, 81, 95.

The same is true in the video context today, and the Commission must again recognize the anticompetitive impact of applying unreasonable build out requirements to a competitive providers. So, for example, application of the same build-out density limitations to a new entrant that were used in the case of a incumbent provider would impermissibly fail to take into account significant competitive differences between the two. Interestingly, these same incumbents who would require Verizon to provide video service everywhere before it can provide service anywhere almost always included density limitations in their own franchise agreements – often 30 households per square mile – to protect themselves from uneconomical deployment. *See* Hazlett Decl. ¶ 16. Yet these cable incumbents have urged that these same limitations are still

[42] *See* Thomas W. Hazlett & George S. Ford, *The Fallacy of Regulatory Symmetry: An Economic Analysis of the 'Level Playing Field' in Cable TV Franchising Statutes*, 3 Business & Politics 21, 24 (2001).

appropriate for a new entrant, despite the vastly different competitive circumstances which makes that demonstrably untrue. Thus, if a new entrant were required to extend its network to all places with a density of 30 households per square mile just because the incumbent did, then that same limitation – intended to protect the incumbent from uneconomical investment – would require the new entrant to invest and deploy under much less economical circumstances. *Id.* ¶ 17. This is because of the simple fact that, unlike an incumbent who enjoyed the benefits of a monopoly position when it built out those areas (*i.e.,* high market share in those sparsely populated areas and likely supra-competitive prices), the competitive provider would be expected to obtain a much lower market share and lower profit margin, given the existence of competition. *See id.* Thus, importing the identical density limitation would make deployment to these same houses significantly more expensive, and likely would prevent deployment altogether.

Likewise, LFAs should be required to take into account differences in network architecture when defining a new entrant's franchise area. As mentioned above, Verizon's FTTP network is not built to correspond to the boundaries of LFA jurisdictions, and when Verizon converts a wire center to FTTP, those facilities might not reach the entirety of a community or could serve parts of several different LFAs. *See* O'Connell Decl. ¶ 24. And while Verizon typically will upgrade throughout a wire center once it begins deployment in that wire center, LFAs should not be able to dictate the timing and scope of that deployment unreasonably. And this is all the more true in the case of attempts to force Verizon or other entrants to build out where they do not have facilities. Any attempt to mandate build-out in areas not served by such

[43] *The Public Utility Commission of Texas*, 13 FCC Rcd 3460 ¶ 13 (1997); *see also Appropriate Regulatory Treatment for Broadband Access to the Internet Over Cable Facilities*, 17 FCC Rcd 4798 (2002) ("*Cable Modem Declaratory Ruling*").

a provider's network should be deemed per se unreasonable given the likelihood that such a requirement would foreclose competitive entry entirely.

Therefore, at a minimum, all relevant differences between providers must be taken into account when imposing any build-out requirements.

C. Demands for Fees or Concessions Beyond Those Permitted by the Cable Act Unreasonably Burden Competitive Entry and Are Preempted.

Another common problem that delays and prevents the awarding of competitive franchises is the common practice of LFAs' demanding things during franchise negotiations – or incumbents' urging them to do so – that the Cable Act or other provisions of federal law expressly prohibit. These demands range from exorbitant application fees to funding for pet projects having nothing to do with the provision of video services or the purposes underlying the franchise requirements.

As an initial matter, with the limited exception of certain PEG funding discussed below, the list of permissible factors set out in Section 621(a)(4) provides no basis for an LFA to condition competitive entry on demands for payments – whether monetary or in-kind – beyond those authorized in the Cable Act's franchise fee provisions. Therefore, except to the extent that other Cable Act provisions, like Section 622, authorize particular fees or items sought by an LFA, Section 621(a) prohibits such demands. As explained above, the pro-competitive purpose of Section 621(a), especially when combined with the limitations imposed on LFA discretion by the First Amendment, prohibits a franchising authority from requesting from a competitive franchise applicant anything that it may not require under the Cable Act.

<u>Second</u>, Section 622 expressly caps the assessments that LFAs may impose. That section provides that a "cable operator may be required under the terms of any franchise to pay a franchise fee," but states that such fee "*shall not exceed 5 percent* of such cable operator's gross

revenues derived . . . from the operation of the cable system to provide cable services." 47 U.S.C. § 542 (emphasis added). Significantly, this provision then defines "franchise fee" broadly to include "any tax, fee, or assessment *of any kind* imposed by a franchising authority . . . on a cable operator . . . because of [its] status as such," subject to certain, specific exceptions (discussed below, where relevant). *Id.* § 542(g)(1) (emphasis added). By using such expansive language ("of any kind"), Congress intended for the franchise fee definition to cover any exaction of value. In addition, the statute excludes from the definition of franchise fee "requirements or charges incidental to the awarding or enforcing of the franchise." *Id.* § 542(g)(2)(D). If "franchise fees" were limited to monetary payments alone, Congress would have had no need to exclude non-monetary items such as a "requirement . . . incidental to the awarding . . . of the franchise" from the franchise fee definition. Moreover, as a practical matter, there is no meaningful distinction between a tax of $1 million and a demand that a cable operator turn over, for example, a small building or a fiber network of equivalent market value. Thus, if the franchise fee definition had been written differently such that it limited only monetary payments, LFAs could evade the 5 percent cap merely by demanding payment in in-kind form.

Therefore, the Cable Act expressly defines "franchise fees" as capturing both monetary contributions required of a cable operator and any in-kind or other compensation required of a cable operator. And it subjects all such contributions – whether monetary, in-kind or otherwise – to the annual 5 percent cap on fees, unless they fall within one of the statutory exceptions to the "franchise fee" definition. As Senator Goldwater noted during the enactment of the Cable Act, "the overriding purpose of the 5 percent fee cap was to prevent local governments from taxing private operators to death as a means of raising local revenues for other concerns." 129 Cong. Rec. S. 8254 (daily ed. June 13, 1983).

This plain text reading of Section 622's franchise fee provision also is compelled by the First Amendment. As discussed above, the First Amendment requires licensing officials to rely on explicit and objective standards that relate to the purposes of the permitting requirement when deciding whether to grant or deny a permit and how much to charge. A regime that gives local officials discretion to determine how much to require a franchise applicant to contribute to the LFA in exchange for the privilege of speaking constitutes an invalid prior restraint. Moreover, irrespective of the procedures used or the standards that may constrain their discretion, licensing officials may not impose excessive fees as a condition of granting permission to engage in protected speech. Because a locality may not charge speakers for the privilege of exercising their First Amendment rights, it can assess only those fees needed "to meet the expense incident to the administration of the [program] and to the maintenance of public order in the matter licensed." *Cox v. New Hampshire*, 312 U.S. 569, 577 (1941) (internal quotation marks omitted). Thus, for example, the First Amendment does not allow a flat license fee to be assessed on religious canvassers where the amount charged is not "imposed as a regulatory measure to defray the expenses of policing the activities in question." *Murdock*, 319 U.S. at 113-14; *see also, Fly Fish, Inc. v. City of Cocoa Beach*, 337 F.3d 1301, 1315 (11th Cir. 2003) (fee was unconstitutional where record failed to show that it was "reasonably related to recouping the costs of administering the licensing program."). Indeed, while the five percent fee has become a de facto floor for franchising fees, it is in fact a statutory *ceiling*. Franchise fees at the five percent level are not automatically consistent with the Cable Act or the First Amendment. Instead, such fees are lawful only if they are justified by the costs that the provider's activity imposes.

Many of the franchising demands Verizon has encountered run afoul of the First Amendment. As described below, many localities have relied on shifting and arbitrary criteria – often unrelated to cable services – when passing judgment on competitive franchise applications. And the obligations some LFAs seek to impose far exceed any reasonable measure of the costs of administering the franchise application process.

Therefore, in light of the constraints imposed on LFA discretion by Sections 621 and 622 of the Cable Act and the First Amendment, many of the demands that LFAs frequently make of a potential new entrant are impermissible. Furthermore, as explained below, other provisions of the Cable Act also expressly forbid, and thus preempt, several of the specific types of demands that Verizon and other new entrants frequently encounter during the franchising process.

1. Funding for Pet Projects Unrelated to Video Services Are Subject to Franchise Fee Limitations.

After Verizon initiates franchise negotiations in an area, it frequently receives in response a wish list prepared by the LFA or its consultants. *See* O'Connell Decl. ¶ 16. In some cases, these lists have included demands designed to have Verizon subsidize a pet municipal project or policy initiative for the municipality as a condition of gaining entry into the video market. *See id.* ¶¶ 41-48. And incumbents encourage these demands, arguing that these extractions of value are required by so-called "level playing field" requirements. Such demands delay, unreasonably burden or even prevent competitive entry in violation of Section 621(a).

An example of this type of behavior comes from one town in Massachusetts which initially demanded, among other things, that Verizon provide funds for the town to purchase street lights from a third party owner; install cell phone repeaters at Town Hall; wire all houses of worship; and make parking available at a Verizon facility for patrons of the public library. O'Connell Decl. ¶ 42.

The Cable Act does not permit an LFA to insist (or even to request) that a competitive provider finance such municipal pet projects, unrelated to video services and unauthorized by the Cable Act, as a condition of gaining entry into the video market. As discussed above, with Sections 621 and 622, Congress attempted to make sure that LFAs could not sacrifice consumer welfare – either because of increased costs of cable service or the creation of barriers to competitive choice – in order to get free library parking or to receive funding for other pet projects. Instead, Section 622 defines "franchise fees" broadly to capture all monetary, in-kind or other contributions paid to a municipality by a cable provider – except to the extent that the payment fits within one of the limited exceptions to that definition – and then applies an annual cap to those fees. *See* 47 U.S.C. § 542. These extra-legal tributes do not fit within any of those exceptions. *See id.* § 542(g).

The Commission should confirm that the statute classifies these items as "franchise fees" and prohibits them to the extent they (along with all other assessments paid to the municipality) exceed the 5 percent annual fee cap. *See* 47 U.S.C. § 542(b). LFA demands for such items of value outside of the context of a permissible franchise fee are per se unreasonable and violate Section 621(a).

Moreover, because these items are a form of "franchise fees," the Commission should recognize that "a cable operator may identify [these items] . . . as a separate line item on each regular bill of each subscriber," *id* § 542(c), and any demands or requests by an LFA that a cable operator forgo this right (as some LFAs have) should be deemed per se unreasonable.

2. Large "Application" or "Acceptance" Fees and LFA Attorneys or Consultants Fees Are Prohibited Except to the Extent Chargeable as Franchise Fees.

Just like businesses that tack on excessive "processing" or "shipping and handling" fees, LFAs frequently demand excessive application or processing fees over and above the 5-percent franchise fees they are authorized to collect under federal law. *See* O'Connell Decl. ¶ 34. These fees are given various names – such as application fees or acceptance fees – but regardless of what they are called, they have the same effect, which is to require Verizon to hand over a large sum of money as a condition of initiating or continuing the franchise process.

In Virginia, many LFAs demand "acceptance fees" at the time Verizon is awarded a franchise. Examples include a county that required Verizon to pay $225,000; one town that required $100,000, and two other cities that required $50,000 each. *Id.* ¶ 35. And other LFAs across the country demand similar fees that add tens of thousands of dollars. *Id.* ¶ 36. Again, these are fees typically assessed in addition to franchise fees, and often are required just to initiate negotiations with an LFA.

Similarly, a number of LFAs have demanded that Verizon pay for the consultants or attorneys hired by the municipality to negotiate on their behalf. Although some LFAs have no problem negotiating a franchise in-house, many LFAs have brought in outside firms of attorneys and consultants whose main purpose and expertise is to extract as much value from the franchise applicant as possible, without regard to the costs such practices have on the viability of competitive entry. *See id.* ¶ 37. Moreover, because these firms typically are paid by the hour (as indicated by the bills that Verizon receives from these firms), they have no incentive to quickly conclude the franchise process, notwithstanding the interests of consumers at large. *See id.*

For example, one county in Maryland is demanding that Verizon pay its expenses and attorneys fees, and has passed an ordinance to that effect. *Id.* ¶ 39. In the county's view, Verizon first should be required to pay the fees of attorneys retained by the county executive to assist in negotiating the agreement, and then, once the agreement is submitted to the county council for approval, would be required to pay the council's separate attorney fees. *Id.* Therefore, this LFA would have Verizon pay for multiple layers of attorneys fees for attorneys hired during different stages of the franchising process. *Id.*

These types of fees and costs demanded of a new entrant qualify as franchise fees under Section 622, in that they are a "tax, fee, or assessment of any kind imposed by a franchising authority or other governmental entity on a cable operator . . . solely because of [its] status as such." 47 U.S.C. § 542(g)(1). And extraneous fees and costs are prohibited under Sections 621 and 622, except to the extent they are chargeable as franchise fees and fit within the annual 5 percent cap on such fees.

Some LFAs may try to argue that these types of fees would be permissible under Section 622(g)(2)(D), which excludes from the "franchise fee" definition any "requirements or charges *incidental* to the awarding or enforcing of the franchise, including payments for bonds, security funds, letters of credit, insurance, indemnification, penalties or liquidated damages." 47 U.S.C. § 542(g)(2)(D) (emphasis added). But any such argument simply cannot be squared with the express statutory terms. As courts that have looked at the issue have found, this exception for "incidental" fees is limited and does not permit LFAs to circumvent the 5 percent cap on franchise fees. *See, e.g., Robin Cable Systems, L.P. v. City of Sierra Vista*, 842 F. Supp 380, 381 (D. Ariz. 1993) ($30,000 fee for "processing costs" was void and unenforceable because it was "more than incidental."). And that conclusion is supported by basic canons of statutory construction which recognize that any general words in a statute – like "incidental" – must be interpreted in a manner consistent with other associated specific words provided in the same provision. *See, e.g., Gutierrez v. Ada*, 528 U.S. 250, 255 (2000) ("Words . . . are known by their companions."); *Jarecki v. G.D. Searle & Co.*, 367 U.S. 303, 307 (1961) ("The maxim *noscitur a sociis* . . . is often wisely applied where a word is capable of many meanings in order to avoid the giving of unintended breadth to the Acts of Congress."). Therefore, the large "application" and "acceptance" fees that some LFAs seek to collect, which differ in kind from the types of "incidental" expenses permitted under Section 622(g)(2)(D), are contrary to federal law and thus preempted.

Moreover, courts have consistently held that consultant and attorneys fees are not "incidental charges" that can be recovered by an LFA outside of the franchise fee cap. *See, e.g., Charter Communications, Inc. v. County of Santa Cruz*, 133 F. Supp. 2d 1184, 1212-14 (N.D. Cal. 2001), *rev'd on other grounds*, 304 F.3d 927 (9th Cir. 2002) (rejecting $39,000 fee for financial consultant, noting that "when a local government's franchise already requires the maximum franchise fee, imposing payment for consultant fees violates the cap"); *Time Warner Entertainment Co. v. Briggs*, C.A. No. 92-40117-GN, 1993 U.S. Dist. LEXIS 1196, *16-18 (D. Mass. 1993) (by charging consultants' and attorneys' fees, two LFAs had imposed additional "franchise fees" in violation of the Cable Act); *Birmingham Cable Communications, Inc. v. City of Birmingham*, No. CV87-L-0755-S, 1989 U.S. Dist. LEXIS 7475, *2 (N.D. Ala. 1989) (finding an "aberrant construction" to conclude that consultants' fees are incidental charges); *see also* 1 Charles D. Ferris & Frank W. Lloyd, *Telecommunications Regulation: Cable, Broadcasting, Satellite, and the Internet*, ¶ 13.16[1][f][i][B] (2005) ("[t]he costs of municipal consultants" not permitted to be charged to franchisee). And this reading of the "incidentals" exception is in accord with ordinary canons of statutory interpretation recognizing that Congress' enumeration of specific, permissible incidental charges suggests the exclusion of charges that are dissimilar to those specifically enumerated. *See, e.g., Circuit City Stores v. Adams*, 532 U.S. 105, 114-15 (2001). Therefore, those fees as well qualify as "franchise fees" and are subject to the annual 5 percent cap.

Section 621(a)'s purpose of facilitating competitive entry reinforces the express terms of the statute's fee provision. It is not a coincidence that the municipalities that have required Verizon to pay their consultant or attorneys fees generally have been the slowest to act on the franchise applications. Shifting these costs to the applicant creates a perverse incentive structure that contravenes Section 621(a)'s statutory requirement that decisions on franchise applications be made promptly and be based solely on the factors enumerated in that section. When LFAs delegate the processing and negotiating of the franchise application to these consultants and attorneys, who in turn are paid by the hour, delay inevitably results. Shifting the costs to the applicant removes the fiscal discipline on the municipality that would otherwise constrain the process, thus further frustrating the purposes of Section 621(a).

Therefore, the Commission should recognize that the express terms of the Cable Act prohibit any fees – whether denominated as "application fees," "acceptance fees," "consultants fees" or otherwise – that exceed the level of incidental, administrative costs of the LFA in reviewing a franchise application or enforcing a franchise, except to the extent those fees are chargeable against the 5 percent annual cap on franchise fees.

3. <u>Franchise Fees for Non-Cable Services Are Prohibited.</u>

Despite clear federal law to the contrary, some jurisdictions have demanded that Verizon agree to pay cable franchise fees based on revenues from non-cable services, such as telephone and Internet access services, as a condition of receiving a competitive video franchise. For example, several communities in Pennsylvania – all of which happen to employ the same consultant – claim that they are entitled to 5 percent of Verizon's future voice and data revenues from FTTP, in addition to their 5 percent fee for cable services. *See* O'Connell Decl. ¶ 52. Such demands are directly contrary to the limitations of Sections 621 and 622 and have already been judged unlawful by the Commission and the courts. Therefore, the Commission should confirm that such demands are prohibited and that delaying or denying a competitive franchise based on such demands is per se unreasonable.

The franchise fee provisions of Section 622 clearly specify that a municipality may only charge a franchise fee on the provision of "cable services," not telecommunications or data services. 47 U.S.C. § 542(b). Based on this limitation, the Commission determined in the *Cable Modem Ruling* that an LFA may not assess franchise fees on non-cable services – in that case, cable modem service – concluding that "revenue from cable modem service would not be included in the calculation of gross revenues from which the franchise fee ceiling is determined."[44] The Commission then tentatively concluded that "Title VI does not provide an independent basis of authority for assessing franchise fees on cable modem service." *Id.*

Following the Commission's ruling, several courts have agreed that Section 622 prohibits municipalities from collecting franchise fees based on revenue from non-cable services. In a decision that is exactly on point, the First Circuit recently held that a municipal ordinance that sought to exact an additional fee for non-cable services in addition to the cable "franchise fee" was contrary to Section 622 and thus was preempted. *See Liberty Cablevision of Puerto Rico, Inc.*, 417 F.3d at 216; *See also City of Minneapolis v. Time Warner Cable*, No. 05-994

[44] *Cable Modem Declaratory Ruling*, ¶ 105.

ADM/AJB, 2005 U.S. Dist. LEXIS 27743, * 17-20 (D. Minn. Nov. 10, 2005); *AT&T Broadband, Inc.*, 2003 U.S. Dist. LEXIS 15453, *16; *see also Time Warner Cable-Rochester v. City of Rochester*, 342 F. Supp.2d 143 (W.D.N.Y. 2004).

Moreover, Section 621(b)(3)(B) expressly prohibits an LFA from seeking fees based on the provision of telecommunications services. That provision prohibits a franchise authority from imposing "any requirement under this title that has the purpose or effect of prohibiting, limiting, restricting, or conditioning the provision of a telecommunications service by a cable operator." 47 U.S.C. § 541(b)(3)(B). Demanding that a cable operator pay fees based on such services as a condition of obtaining a cable franchise would necessarily have such an effect.

Therefore, any effort by an LFA to demand fees on non-cable services offered by a cable operator is unlawful, and the Commission should recognize that demands to that effect are per se unreasonable. And any State or local laws to the contrary are preempted. 47 U.S.C. § 556.

D. Many Common PEG Demands Are Contrary to Federal Law and Invalid.

Another related issue that often delays, and sometimes completely derails, franchise negotiations is the extent of the applicant's PEG obligations. At the urging of incumbents citing so-called "level playing field" requirements, LFAs frequently demand excessive fees or other concessions from a new entrant that the LFAs say will be used to support PEG channels or facilities. The Commission should recognize that Sections 611, 621, and 622 sharply limit the PEG-related demands that LFAs can impose. Demands for support beyond those limits established by the Cable Act are contrary to federal law and preempted.

At the insistence of the cable incumbents, LFAs typically require a new entrant to provide, at a minimum, the same "PEG support" as the incumbent. O'Connell Decl. ¶ 29. In fact, in some cases LFAs have not only required Verizon to match the PEG support that the incumbent provides, but also have required Verizon to provide even greater levels of support or to carry more PEG channels. *Id.* ¶ 33. And many LFAs demand this level of funding or support despite the fact that it will enrich the LFA far beyond what it needs to support its PEG channels and programming. *Id.* ¶ 29. This is because, in the vast majority of cases, the facilities and equipment needed to develop PEG programming (*e.g.,* studios, cameras, etc.) have already been deployed, and are not even being used to their capacity. *Id.* Not surprisingly, in Verizon's experience LFAs do not make a showing to Verizon that they need additional PEG support beyond the levels they already receive in order to actually *support PEG*. *Id.*

For example, one franchising authority in Florida demanded that Verizon meet the incumbent cable operator's cumulative payments for PEG, which would exceed $6 million over 15 years of Verizon's proposed franchise term. *Id.* ¶ 30. When Verizon rejected this demand, the LFA doubled its request, asking for a fee in excess of $13 million that it said would be used for both PEG support and the construction of a redundant institutional network. *Id.* Similarly, one California community initially demanded that Verizon match the cumulative PEG support that the incumbent had made over time. *Id.* ¶ 31. This included up-front charges of more than $500,000 for PEG access equipment and facilities, and revolving charges that bring the total up to approximately $1.7 million over the course of the franchise. *Id.* And several franchising authorities in one metropolitan area charge a three percent fee for "PEG support" on top of the five percent cable franchise fee. *Id.* ¶ 32. Here again, these jurisdictions make no effort to demonstrate that the extra three percent fee is actually used to support PEG. *Id.*

And the unreasonable PEG demands are not limited to funding. Some franchising authorities have also demanded that Verizon take on unreasonable PEG carriage obligations, including sometime obligations that exceed those of the incumbent. *Id.* ¶ 33. For example, one community in Massachusetts has demanded that Verizon set aside 10 PEG channels, while the incumbent provides only two. *Id.*

An increasingly common practice engaged in by incumbent operators further increases the PEG burdens or new entrants. Several incumbents have refused to negotiate with Verizon for PEG channel interconnection. O'Connell Decl. ¶ 75. This anticompetitive practice has no justification other than to increase Verizon's costs by requiring it to incur substantial expense to acquire access to the PEG channels that it is required to carry. *Id.* In fact, incumbents have even tried to force this unnecessary expense in Texas, where the recent legislation specifically requires them to interconnect for purposes of transmitting PEG signals. *Id.* Yet, so far, LFAs have not required the incumbents to provide this interconnection on reasonable terms in order to facilitate the carriage of the channels that they mandate. *Id.* The refusal to interconnect under these circumstances is a transparent attempt delay competition.

Despite the prevalence of these demands for PEG support, the Cable Act's PEG provisions are more modest – particularly in the case of new entrant. The Act contemplates only four forms of PEG contributions: channel capacity, facilities, equipment, and financial support. Channel capacity refers to channels that cable systems set aside for PEG programming. Facilities, the legislative history indicates, includes such things as studios, or other physical infrastructure needed to produce PEG programs. *See* H.R. Rep. No. 98-934, at 45 (1984). Equipment includes items such as cameras. *Id.* Financial support, as its words suggest, includes monetary payments that directly support PEG programming. The Act also speaks of PEG "access facilities" and defines that term to mean both "channel capacity designated for [PEG]" and "facilities and equipment for the use of such channel capacity." 47 U.S.C. § 522(16).

The Act prescribes different limits on each form of PEG support. First, Section 611 specifically permits franchising authorities to require cable operators to designate a reasonable amount of channel capacity for PEG programming. 47 U.S.C. § 531. Second, Section 621(a)(4)(B) provides that LFAs "may require adequate assurance that the cable operator will provide adequate public, educational, and governmental access channel capacity, facilities, or financial support." *Id.* § 541(a)(4)(B). Finally, Section 622 of the Act provides that for new cable entrants, all PEG payments other than reasonable capital costs for PEG access facilities will count against the 5 percent cap on franchise fees. *Id.* § 542(b), (g)(2)(C). By contrast, incumbent providers whose franchises were in effect at the time of the 1984 Act may be required to pay a wider range of PEG expenses above and beyond the 5 percent fee cap. *Id.* §542(g)(2)(B) (exempting from the fee cap for legacy franchises "payments . . . for, or in support of the use of, [PEG] access facilities"). These three provisions, taken together, render many municipal PEG demands unlawful.

First, Section 611 deprives LFAs of authority to require operators to provide any PEG support beyond a reasonable amount of channel capacity. Section 611(a) authorizes LFAs to establish requirements "with respect to the designation or use of channel capacity for [PEG] use *only to the extent provided in this section*." 47 U.S.C. § 531(a) (emphasis added). Section 611(b), in turn, allows a franchising authority to require in its requests for proposals (RFPs) "that channel capacity be designated for [PEG] use." *Id.* § 531(b). Thus, reading these two provisions together, the Cable Act empowers LFAs only to insist on PEG "channel capacity."

While permitting an LFA to require the designation of a reasonable amount of channel capacity for PEG uses, the Act also limits what LFAs can demand in these regards. Section 621(a)(4)(B) allows LFAs to require no more than an "adequate" number of designated channels

– a number that the legislative history indicates means no more than three. *See Senate Report*, at 53 (stating that mandatory channel access requirements "should specify only a reasonable amount of channel capacity for access by other parties . . . . [W]hether particular Public, Educational, and Governmental (PEG) allocations are reasonable would depend on the facts of each case. For example, an allocation of at least three channels on most systems would certainly appear reasonable.").

Section 611(c) confirms the permissible scope of PEG obligations that can be *required* of a new entrant. That provision states that LFAs may enforce "any requirement in a franchise regarding the providing or use of such channel capacity," including "any provisions of the franchise for services, facilities, or equipment" – but only if they are "proposed by the cable operator." 47 U.S.C. § 531(c). In other words, while this provision ensures that LFAs can enforce promises of PEG facilities or financial support once reduced to a franchise agreement, it specifically contemplates that such commitments would come from voluntary concessions by the operator – not from any LFA-imposed requirement.

Section 621(a)(4)(B), which allows LFAs to require "adequate assurance that the cable operator will provide adequate [PEG] access channel capacity, facilities, or financial support," does not alter this limitation. 47 U.S.C. § 541(a)(4)(B). That provision authorizes an LFA only to require *assurances* that a cable operator will live up to its PEG commitments – which would include any reasonable PEG channel capacity requirements that the LFA may have demanded in an RFP and any promises of facilities or financial support that the operator voluntarily agreed to provide in negotiations with the LFA. These "assurances" include, for example, a bond or letter of credit. A contrary reading of this provision – namely, one that permits local franchisors to *require* operators to provide facilities, equipment or financial support – is unsupportable because it would empty Section 611's limitation of any meaning. Such a result would violate the "cardinal rule . . . that repeals by implication are not favored." *Posadas v. National City Bank of New York*, 296 U.S. 497, 503 (1936) (where the legislature's intent to repeal is not "clear and manifest," "the later act is to be construed as a continuation of, and not a substitute for, the first act").

Second, even if Section 621(a)(4)(B) were construed to authorize LFAs to require PEG facilities or financial support, the Act still would prohibit many of the exorbitant demands LFAs have made. With respect to PEG financial support, the Act's franchise fee provision provides that any such support, *i.e.*, direct monetary payments that subsidize PEG programming, counts against the 5 percent franchise fee cap. 47 U.S.C. § 542(g)(2)(C) (exempting only "capital costs which are required by the franchise to be incurred by the cable operator" from the fee cap). Thus, where an LFA taxes gross cable revenues at the 5 percent level, it may not require a competitive entrant to contribute any PEG financial support at all. Furthermore, this provision makes clear that the limitation to "capital costs" must be strictly construed and that LFAs must be able to establish that any PEG payments do, in fact, cover permissible capital costs. Otherwise, the statutory limitation would be toothless because there would be no way to determine what part of the PEG payment counts against the fee.

Other provisions limit the facilities requirements an LFA may impose. Although capital costs for facilities are exempted from the 5 percent franchise fee ceiling, Section 621(a)(4)(B) provides that an LFA may require only "adequate assurances" of "adequate" PEG facilities.[45] 47

[45] So-called "level playing field" requirements cannot abrogate this limitation. The express terms of Section 622 provide that an incumbent may be subject to PEG obligations that exceed those of a new entrant. *Compare* 47 U.S.C. § 622(g)(B) with *id.* § 622(g)(C); *see also* subsection II(g), *infra*. And to the extent state or local level playing field requirements violate these provisions of federal law, they are preempted. *See* 47 U.S.C. § 556. Moreover, any attempt to

U.S.C. § 541. The term "adequate" precludes LFAs from imposing onerous or excessive demands for facilities. At the same time, the term "capital costs" limits the LFA to those costs incurred in the construction of PEG access facilities, and does *not* include "payments for, or in support of the use of, PEG access facilities," such as equipment costs, salaries, and training. *See Cable TV Fund 14-A, Ltd. v. City of Naperville*, No. 96C5962, 1997 WL 433628, at *12 (N.D. Ill. July 29, 1997) ("Capital costs refer to those costs incurred in or associated with the construction of PEG access facilities . . . and are distinct from payments for, or in support of the use of, PEG access facilities") (citation omitted). In the vast majority of cases where a new entrant seeks to compete against an incumbent, additional PEG facilities needs should be extremely limited because the facilities needed to develop PEG programming generally would have already been deployed. The facilities costs required do not materially increase simply because a new firm enters.

An LFA also is not permitted to impose additional expenses or obligations on a new entrant just because the incumbent provider incurred particular expenses in the past. As explained below in section II(G), such a requirement would impose a tax on new entry that is contrary to Section 621(a) and that is unjustified under any other provision of the Cable Act. And given Section 621(a)(4)'s requirement that any PEG assurances be limited to that which is reasonable and "adequate" – any requirement to provide channel capacity or any form of support, such as capital costs, must be based on the LFA's current and reasonable PEG needs, and not on what may have been required at some point in the past.

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force a new entrant to build a redundant PEG studio just because the incumbent had agreed to build one years ago –would certainly go beyond any reasonable interpretation of "adequate." *See* 47 U.S.C. § 541(a)(4)(B).

Finally, with respect to all PEG contributions, the statute makes clear that LFAs may not reasonably require new entrants to make greater PEG contributions than the incumbent provider. As explained above, Section 622, the franchise fee provision, provides that incumbent operators may be required to undertake greater PEG commitments than new cable entrants. *Compare* 47 U.S.C. § 542(g)(2)(B) (for legacy franchises, exempting from franchise fee cap "payments . . . for, or in support of the use of, [PEG] access facilities"), *with id.* § 542(g)(2)(C) (for new franchisees, exempting only "capital costs" for PEG access facilities). Thus, the Commission should confirm that in no case may an LFA require a competitive provider to pay higher PEG contributions than the incumbent. The pro-competitive purposes of the Act only reinforce this conclusion.

The statute's limitation on the permissible scope of a new entrant's PEG obligations is bolstered by the First Amendment. First, at a minimum, the prior restraint doctrine necessitates narrow and objective limits on LFA discretion to determine what PEG demands are "adequate." *See, e.g., Forsyth,* 505 U.S. at 130. The current system, in which LFAs rely on shifting and arbitrary criteria to define a provider's PEG responsibilities and demand exorbitant PEG contributions, raises serious constitutional questions. Second, even assuming that PEG channel capacity requirements are content-neutral (which they are not), excessive PEG channel demands would run afoul of the First Amendment prohibition against unduly broad burdens on protected speech. When LFAs insist on large numbers of PEG channels – many of which duplicate existing programming and which attract only small audiences – they crowd out significant cable operator speech while doing little to promote diversity in cable programming. In this sense, onerous PEG channel set-asides cannot be said to be narrowly tailored to governmental objectives. *See Turner I*, 512 U.S. at 662.

Thus, the Commission should recognize that the Cable Act prohibits excessive municipal PEG demands. In addition, to give effect to the statute's limits on facilities and financial support, the Commission should make clear that LFAs must document and track PEG payments properly. The Commission should prevent LFAs from, for example, recasting financial support payments as PEG-related capital contributions that fall outside the 5 percent fee cap. The Commission also should prohibit LFAs from using PEG payments for non-PEG uses, and should require LFAs to document that these contributions were used appropriately, if challenged.

E. Most Demands for Institutional Network Facilities or Support Are Invalid.

A related – equally invalid – request that Verizon has frequently encountered during franchise negotiations is for Verizon to construct broadband data networks for a municipality, or to offer free data services to the municipality or to other people or organizations selected by the LFA. Many of these demands are dubbed requests for "institutional networks" or "I-Nets." A fundamental problem with these demands is that they generally stray from what the Cable Act permits an LFA to require. The Commission should confirm that these demands are contrary to the express terms of the Cable Act, and are thus precluded. Moreover, any delay in granting a competitive franchise as a result of the applicant's unwillingness to accede to such demands is per se unreasonable.

Section 611 defines an "institutional network" as "a communications network which is constructed or operated by the cable operator and which is generally available only to subscribers who are not residential subscribers." 47 U.S.C. § 531(f). Despite this limited definition, however, some LFAs demand that new entrants provide all manner of non-video communications networks or services that they characterize as "institutional networks" or "I-Nets" as a condition of receiving a franchise. For example, one LFA in Virginia initially demanded that Verizon connect 220 traffic signals in the county with fiber; provide fiber services to "approximately 60" organizations who "work with" the county's "Department of Human Services to provide medical, psychological, educational, nutritional, employment and housing assistance to at risk segments of the community"; provide cell phones for "approximately 1000 employees"; and provide discounted broadband access in public housing. *See* O'Connell Decl. ¶ 43. Only after more than a year of negotiations, did the county drop some of these demands. *Id.*

Similarly, several other LFAs have asked Verizon to construct or provide fiber networks for all of the public buildings in the community. For example, another LFA in Virginia required Verizon to provide eight-strand dark fiber to all public buildings, even though all of these buildings already are wired with fiber. *Id.* ¶ 44. Verizon estimates that the price for providing these facilities to an ordinary retail customer would be approximately $2.3 million. *Id.* And many other LFAs have asked Verizon to provide non-video services like Internet access service, cell phone service, or wireless broadband service (EvDO) – services clearly available to residential customers and thus, by definition, not "I-Nets" – to local government, its employees, or chosen others for free or at a discount. *Id.* ¶ 45.

These demands are unlawful for two fundamental reasons. First, many of these demands far exceed the limited authority that an LFA is given with respect to an I-Net – to designate channel capacity on such a network, if it already exists. Second, many LFAs request services or facilities that are not institutional networks in the first place (much less capacity on an institutional network).

<u>First</u>, many LFAs take the position that they may require a franchise applicant to construct I-Net facilities for the LFA as a condition of obtaining a franchise. In fact, Section 611

– on which LFAs' I-Net authority is based – is much more limited. That provision begins by stating that an LFA "may establish requirements in a franchise with respect to the designation or use of channel capacity for public, educational, or governmental use *only to the extent provided in this section*." 47 U.S.C. § 531(a) (emphasis added). Then, it goes on to spell out what an LFA may require, providing that an LFA "may in its request for proposals require as part of a franchise . . . that channel capacity be designated for [PEG] use, *and channel capacity on institutional networks be designated for educational or governmental use*." *Id.* § 531(b).

Notably absent from Section 611 is anything giving an LFA permission to require the *construction* of an I-Net. Instead, it very clearly limits a municipality's authority to requiring channel capacity on such a network. The Commission previously has reached this same conclusion when applying Section 611 to open video system operators, *see* 47 C.F.R. § 76.1505(e), and that interpretation of Section 611 was confirmed by the Fifth Circuit. *City of Dallas v. FCC*, 165 F.3d 341, 350 (5th Cir. 1999). The court concluded that "§ 611 does not permit localities to require cable operators to build institutional networks, but instead, by its terms, merely states that" an LFA may require channel capacity on an existing network that qualifies as an I-Net. *Id.* "In other words, localities may require that cable operators devote space on their existing institutional networks, if there are any such networks, to educational or governmental use, but the statute does not authorize local governments to *require* the construction of institutional networks." *Id.* Therefore, LFAs lack authority to require a new entrant to build an I-Net, and the Commission should deem per se unreasonable any request or demand to the contrary.[46]

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[46] Section 621(b)(3)(D)'s reference to I-Nets is not to the contrary. That section states that "[e]xcept as otherwise permitted by sections 611 and 612, a franchising authority may not require a cable operator to provide any telecommunications service or facilities, *other than*

Second, some LFAs fundamentally misinterpret the meaning of "institutional network," and seek to require Verizon to provide all sorts of broadband data services and facilities to which they are not entitled. As noted above, the statute defines an I-Net as "a communications network . . . which is generally available only to subscribers who are not residential subscribers." 47 U.S.C. § 531(f). None of the in-kind services typically sought by LFAs – such as broadband Internet access services – qualify under this definition because, among other reasons, these services generally are sold to residential subscribers. Moreover, given the references to "channel capacity" and "subscribers" in Section 611, this definition cannot reasonably be read to include the types of broadband services or special access services that Verizon sells to business customers. Therefore, the Commission should confirm that the express terms of the Cable Act prohibit an LFA from demanding the construction of any networks or facilities or seeking for free the types of broadband services that Verizon is in the business of selling to both residential and business customers. And any demand that a new entrant provide such facilities or services as a condition of obtaining a video franchise should be deemed per se unreasonable.

F. Local Assertions of Regulatory Control over Non-Cable Services Are Barred.

Despite clear federal law to the contrary, some jurisdictions have sought to assert regulatory control over non-cable services or facilities by bootstrapping to their cable franchising power, and have refused to grant a cable franchise to Verizon when it has resisted. For example, some counties in Maryland have demanded that Verizon submit its data services to local customer service regulation as a condition for receiving a video franchise. O'Connell Decl. ¶ 51.

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institutional networks, as a condition of the initial grant of a franchise." 47 U.S.C. § 541(b)(3)(D) (emphasis added). As the Fifth Circuit recognized, that provision cannot be viewed as an independent grant of authority. *See City of Dallas*, 165 F.3d. at 351 n.10 (concluding that it was "[o]bvious[]" that "the obligation [to construct an I-Net] could not stem from § 621(b)(3)(D)").

One city in that State has gone so far as to insist that Verizon obtain a separate franchise prior to deploying FTTP in its jurisdiction. *Id.* ¶ 54. And, as explained in more detail below in section III, incumbent cable operators and some LFAs have suggested that a cable franchise should endow an LFA with broad new authority to regulate the entirety of a provider's broadband network, even when that network was built pursuant to an independent grant of authority under the telecommunications laws.

Nothing in Section 621(a)(4)'s list of factors that Congress allows LFAs to consider – nor anything else in the Cable Act – authorizes LFAs to leverage their video franchising authority in this manner. To the contrary, other parts of Section 621 expressly forbid just that. Section 621(b) specifically provides that a "cable operator or affiliate shall not be required to obtain a franchise under this title for the provision of telecommunications services," and prohibits an LFA from "impos[ing] any requirement ... that has the purpose or effect of prohibiting, limiting, restricting, or conditioning the provision of a telecommunications service by a cable operator or an affiliate thereof." 47 U.S.C. § 541(b). Thus, LFA demands to this effect are patently unlawful and are preempted. *See id.* § 556.

G. So-Called "Level Playing Field" Requirements That Act as Barriers to Entry Should Be Preempted.

Finally, another common impediment to competitive entry comes from so-called "level playing field" requirements that many incumbent cable operators have convinced various jurisdictions to adopt. These protectionist requirements are often cited as a basis for imposing all manner of additional costs and obligations on a would-be new entrant into the market – including many of the unreasonable demands for build-out, unlawful PEG support, to other extraneous demands discussed above. Incumbents, with some success, have argued that these provisions require a new entrant – as a price of entering the market – to match all of the various concessions previously provided by the incumbent in exchange for its original monopoly position in the local area, despite the vastly different competitive situation facing the new entrant. That view is a transparent attempt to increase a new entrant's costs, thus making it less likely that the entrant would enter the market at all. *See* Hazlett Decl. ¶¶ 15-20. These requirements – at least when interpreted to impose on a new entrant all of the costs previously incurred by an incumbent – are contrary to Section 621(a) and should be preempted.

Here again, the cable incumbents once viewed the imposition of legacy requirements on new entrants in a market very differently. The president of NCTA once warned Congress of "state laws and regulations that appear to be 'neutral' conditions on the provision of service but [that], as historically applied, amount to barriers to new entrants." *The Communications Act of 1994: Hearing on S. 1822 Before the Senate Commerce Committee* (May 4, 1994) (statement of Decker Anstrom President and CEO National Cable Television Association). The cable incumbents' got it right the first time.

The negative effects of so-called "level playing field" requirements on competition may not at first be apparent because, as a general rule, creating a level economic playing field makes sense. The problem is that, as an economic matter, the ostensibly equal burdens required under these laws in fact impose a much heavier burden on new entrants than on incumbents and thus create barriers to entry. *See* Hazlett Decl. ¶ 17. In exchange for the costs they incurred to enter the market, the incumbents generally received exclusive franchises and enjoyed all of the benefits of being monopoly providers for years, and often decades. *Id.* ¶ 16. In contrast, a competitive video provider who enters the market today is in a fundamentally different situation, facing ubiquitous competition from strong and entrenched competitors, which in turn leads to lower market share and lower profit margins. *Id.* ¶ 17. Therefore, as Dr. Hazlett explains, these "nominally symmetric obligations" in fact create an often insurmountable tax on competitive entry by forcing a new entrant into the video business to incur the kinds of costs that the incumbent was able to recover over the years when it enjoyed a monopoly franchise. *Id.* ¶ 19-20.

Given this effect on competitive entry, any "level playing field" requirements that would impose costs on a new entrant just because the incumbent incurred such costs in exchange for its monopoly position in the market violate Section 621(a), and should be preempted. Furthermore, as discussed above, any "level playing field" requirement that would treat a new entrant as a target of opportunity and burden competitive entry in ways not expressly authorized by the limited list of enumerated factors on which the franchising decision must be based, *see* 47 U.S.C. § 541(a)(4), should be expressly preempted. These rules cannot convert an otherwise unlawful demand into a permissible one.

At a minimum, the Commission must recognize that these so-called "level playing field" requirements create an impermissible barrier to entry if they fail to take into account all relevant differences between providers, including but not limited to differences in their competitive position in the market and their overall regulatory burdens.[47] As the Commission has recognized in the past, new entrants are, by definition, differently situated from incumbents, and imposing identical obligations on new competitors as a price of entering the market would unreasonably deter entry.[48] And this is no less true in the context of video services; as discussed throughout

[47] *See* Hazlett & Ford, 3 Business & Politics at 24.

[48] Both the Commission and the Department of Justice have previously recognized this fact in several other contexts. *See, e.g.,* Comments of the United States Department of Justice, *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, CC Docket No. 96-98 at 6-7 (filed May 16, 1996) (opposing concept that "entrants should … be subjected to unnecessary regulation in order to satisfy notions of competitive 'equity.' Incumbent LECs are subjected to regulatory restrictions largely because they possess substantial market power. Absent possession of market power, there is no reason to subject entrants to the same constraints, and there is a substantial cost to competition in doing so."); *Applications of*

these comments, both in Section 621(a) and in other provisions of the Cable Act Congress fully intended to diminish the burdens associated with competitive entry.

Moreover, any permissible application of these requirements would require consideration of the overall regulatory burdens of different providers as a result of all of the services that they offer. For example, on the telephone side of its business, Verizon is subject to a number of obligations by virtue of being an incumbent local telephone company from which cable operators are exempt, even when they offer telephone service. At the same time, neither the Commission nor the states have ever required cable companies and other telecommunications services competitors to match all of the obligations imposed on the incumbent telephone companies, such as carrier of last resort obligations or the obligation to provider service throughout a territory. Instead, competitive telephone providers – including all the major incumbent cable companies – are generally permitted to provide service where and to whom they choose within each state, after making the minimal showing required to become certified as a competitive provider. *See* Hazlett Decl. ¶¶ 25-31. This lighter regulatory approach to competitive providers also shows why it is necessary to take into account the totality of the regulatory circumstances when judging whether two different providers are subject to comparable regulation.

Therefore, the Commission should preempt any so-called "level playing field" requirements that seek to impose unreasonable and unlawful cost on a new entrant, as such requirements violate Section 621(a)'s pro-competitive mandate. And even in the case of less

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Contel of Virginia, Inc., doing business as GTE Virginia, et al., for Authority To Construct, Operate, and Maintain Facilities To Provide Video Dialtone Service to Communities in Virginia, Florida, California, and Hawaii, 10 FCC Rcd 12672, ¶ 38 (1995) (noting in the case of video dialtone provider that "market forces should determine how and when the technology is deployed and services are offered to the public").

extreme requirements, the Commission must require that all relevant facts and circumstances of different providers be taken into account when applying these requirements.

III. The FCC Should Construe the Act's "Cable System" Definition in Accordance with Section 621 and Other Provisions of the Act and the First Amendment.

In addition to the problems Verizon has experienced in the process of *obtaining* a video franchise, some LFAs have threatened to exercise a degree of regulatory authority *after a franchise has been granted* that would undermine the federal policy objectives concerning video competition and broadband deployment. In particular, some LFAs and cable companies have said that once Verizon begins to offer video over its FTTP network, the entirety of the network should be regulated as a "cable system" for all purposes. *See* O'Connell Decl. ¶ 49. According to these parties, addition of video to the network gives broad new authority to municipalities over the entire physical network, including authority to regulate aspects of the construction, operation or placement of these networks. And they have suggested that this is so even though the mixed-use network also delivers voice and data services and was upgraded to FTTP pursuant to independent grants of authority under telecommunications laws. Before these claims become more of a deterrent to deployment than they already are, the Commission should issue a preemptive and binding determination that this expansive view of municipal authority and of the "cable system" definition is contrary to Section 621(a) and several other provisions of federal law.

Some LFAs – spurred on by cable incumbents seeking to delay competition – have expressed their intentions to exercise added control over the deployment and operation of FTTP facilities once video is added to the network. For example, in a filing before the New York PSC, the towns of Larchmont and Mamaroneck asserted that once Verizon has a cable franchise in their communities, they will have regulatory authority to require Verizon to "entirely rebuild" its system (*e.g.*, bury the entire fiber plant underground). *See* O'Connell Decl. ¶ 53.[49] And these towns maintained that they could demand this "regardless of the impact on Verizon." O'Connell Decl. ¶ 53. Similarly, one town in Virginia has refused even to give Verizon permits to upgrade its network to FTTP (before the cable franchise process has even begun), demanding that Verizon bury the fiber at a cost of $3-4 million. *Id.* ¶ 55.

If these assertions of redundant and conflicting regulatory control were permitted, they would make entry into the video market extremely difficult and costly – especially if imposed uniformly on Verizon by all of the municipalities it serves. If each LFA were permitted to impose a unique set of costly conditions on Verizon FTTP network, Verizon would have to make system-by-system adjustments that would increase costs and reduce the efficiencies of planning and operating on a region-wide or national basis. *See id.* ¶ 50. This would undermine the significant scale economies which make deployment of FTTP feasible, and which is one of the key reasons Verizon believes it can succeed in the video market. *See id.* This scale would not be possible for a national broadband network that is subjected to thousands of sets of competing regulations concerning how the network must be deployed in each community.

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[49] In proceeding before the New York Public Service Commission addressing the issue of whether Verizon was required to obtain a franchise before it could deploy FTTP at all in light of its intent to offer video services over that network at a later time, the Larchmont-Mamaroneck Cable Television Board of Control contended that if a franchise is not required prior to FTTP construction (as the Commission ultimately ruled in that proceeding), then "*post hoc*, and regardless of the impact on Verizon, Verizon could be required to *entirely rebuild its system* to meet local needs and interests: that is, Verizon must assume all risks associated with construction prior to franchising." Comments of Larchmont-Mamaroneck Cable Television Board of Control in Support of the Petition, N.Y. P.S.C. Case 05-M-0250, at 6 (filed May 6, 2005) (emphasis added). The New York PSC has rejected these types of extreme claims. *See* footnote 50, *infra*.

A. The Entirety of a Mixed-Use Broadband Network Is Not a "Cable System."

Those LFAs and cable incumbents who take this extreme position maintain that the mere act of transmitting video service over a portion of the bandwidth of the FTTP network converts the entirety of the physical network into a "cable system," thus triggering broad, new municipal authority to impose precisely the kinds of burdens on the ongoing construction, repair, and replacement of the physical FTTP network that they could not impose prior to that time.

All of this puts a would-be competitive provider to a Hobson's choice: resist unreasonable demands, in which case franchise authorities simply withhold action resulting in costly delays and litigation; or accede and suffer the death of a thousand cuts as individual municipalities impose conflicting and costly new requirements. Indeed, Verizon already is engaged in hundreds of individual franchise discussions across the country, and in the near term that number could reach into the thousands. This result may be to the liking of the cable incumbents, but it can hardly be said to be in the interests of consumers or to be consistent with federal policy. Indeed, one State public service commission recently recognized this fact and expressly rejected this extreme view of the regulatory power afforded to municipalities when video services are added to an FTTP or other mixed-use networks.[50]

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[50] In two orders confirming franchise agreements that Verizon had reached in two communities, the New York Public Service Commission expressly rejected claims that a cable franchise would provide an LFA with "broad new authority over the construction, placement and operation of Verizon's mixed-use [FTTP] facilities" that could, for example, permit an LFA to "requir[e] the undergrounding of mixed-use facilities." *Petition of Verizon New York Inc. for a Certificate of Confirmation for its Franchise with the Village of South Nyack, Rockland County*, New York Public Service Commission, Case 05-V-1571, at 8 (Feb. 8, 2006); *Petition of Verizon New York Inc. for a Certificate of Confirmation for its Franchise with the Village of Nyack, Rockland County*, New York Public Service Commission, Case 05-V-1570, at 8 (Feb. 8, 2006). Those conclusions of the PSC are unquestionably correct. The PSC's orders do note, however, that once video is provided over the FTTP network, the State's minimum cable rules apply to "the entirety" of the FTTP network. *Id.* at 7. As discussed below, that legal conclusion is contrary to binding federal law.

In addition to being bad policy, this expansive view of local authority over national, mixed-use broadband networks cannot be sustained under binding federal law, including Section 621(a). When an LFA demands something of a franchise applicant that it is not permitted to require under the Cable Act – as is true of these demands that a provider cede additional authority to a municipality over its physical FTTP network as a condition of receiving a video franchise – such demands unreasonably obstruct competitive entry into the video market.

In addition to Section 621(a), these arguments by some LFAs and incumbents run afoul of several other provisions of federal law and policy. First, the Cable Act's definition of "cable system" is explicit that a common carrier's network that is subject in whole or in part to federal Title II regulation – such as Verizon's FTTP network – is a cable system only "*to the extent*" it is used to transmit video programming directly to subscribers. 47 U.S.C. § 522(7)(C) (emphasis added). This language makes it clear that the entirety of a telecommunications/data network is not automatically converted to a "cable system" once subscribers start receiving video programming. If Congress had intended an automatic and total conversion, it would have said that a common carrier's network becomes a cable system "if" or "whenever" it is used to offer video programming, not "to the extent" that it is so used.

This interpretation, as well as being the only one that is consistent with the express terms of the federal statute, is eminently reasonable. The purpose of franchise requirements is to preserve local control over the use of public rights-of-way. However, where an entity such as Verizon already has access to local rights-of-way in its capacity as a telecom carrier, the mere fact that it also provides cable service does not change the character or extent of its use of the rights-of-way. Moreover, Verizon is already subject to significant state and local authority over its construction activities under generally applicable telecom law. There is thus no need to stretch to interpret the "cable system" definition in a manner that would give municipalities additional and potentially inconsistent control over Verizon's placement or operation of the physical FTTP network.

This construction of the term "cable system" is also reinforced by other provisions of federal law. As discussed above, Section 621(b)(3)(B) prohibits a franchise authority from imposing "any requirement under this title that has the purpose *or effect* of prohibiting, limiting, restricting, or conditioning the provision of a telecommunications service by a cable operator." 47 U.S.C. § 541(b)(3)(B) (emphasis added). Such an effect would be inevitable if, as the cable incumbents urge, franchising authorities were granted greatly expanded power over the physical FTTP facilities, which are used to provide telecommunications and data services as well as video, once cable service travels over a portion of the bandwidth of the network.

Likewise, Section 253(a) of the Telecommunications Act prohibits state or local regulation that "may prohibit *or have the effect of prohibiting* the ability of any entity to provide any interstate or intrastate telecommunications service."[51] Burdensome or inconsistent requirements imposed on FTTP facilities used for the delivery of multiple services would have precisely such a prohibitory effect. In applying Section 253, the Commission has stated that, in determining whether an ordinance has the effect of prohibiting the provision of telecommunications services, it "considers whether the ordinance *materially inhibits or limits* the

[51] 47 U.S.C. § 253(a) (emphasis added). Section 253(c) states that "[n]othing in this section affects the authority of a State or local government to manage the public rights-of-way or to require fair and reasonable compensation from telecommunications providers, on a competitively neutral and nondiscriminatory basis, for use of public rights-of-way on a nondiscriminatory basis, if the compensation required is publicly disclosed by such government." However, in light of the fact that Verizon is *already* subject to legal requirements relating to the use of public rights-of-way for telecommunications facilities (including FTTP facilities), and the fact that the transmission of video programming does not impose any incremental burdens on such rights-of-way, Section 253(c) does not come into play here.

ability of any competitor or potential competitor to compete in a fair and balanced legal and regulatory environment." *California Payphone Association Petition for Preemption*, 12 FCC Rcd 14191, ¶ 31 (1997); *TGC New York, Inc. v. City of White Plains*, 305 F.3d 67, 76 (2d Cir. 2002) (same). And courts have preempted all manner of local laws that placed burdensome or discriminatory obligations on a provider of telecommunications services. *See, e.g., Qwest Communications Inc. v. City of Berkeley*, Docket No. 03-15852, slip op., at 623 (9th Cir. Jan. 12, 2006) (various requirements, "when considered together, are patently onerous and have the effect of prohibiting Qwest and other telecommunications companies from providing telecommunications services"); *TGC*, 305 F.3d at 76-81. Municipal ordinances are particularly suspect to the extent that they "afford[] the City significant discretion to deny companies the ability of providing telecommunications services," as regulation by an LFA certainly would. *Qwest*, at 623.

Thus, subjecting a national broadband network to the vagaries of the local franchising process, and the varied and conflicting demands of thousands of different municipalities would undoubtedly "have the effect of prohibiting the ability of any entity" to provide telecommunications services over these networks. And the Commission must find that Section 253 requires preemption of municipal efforts to regulate as a "cable system" the construction, placement and operation of a multi-use national, broadband network deployed pursuant to generally applicable telecommunications laws.

Section 624(e) also prohibits franchising authorities from conditioning or restricting Verizon's choice of transmission technology. 47 U.S.C. § 544(e). And again, permitting municipal authority over the entirety of an FTTP network would have just that effect.

The result urged by these LFAs and cable incumbents also would be flatly inconsistent with the articulated state and federal policies promoting video competition and broadband deployment. For example, Section 706(a) of the 1996 Act expressly directs the Commission, as well as other federal and state regulators, to promote the deployment of advanced telecommunications networks.[52] That section states, in part, that "[t]he Commission . . . *shall* encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans . . . [by] remov[ing] barriers to infrastructure investment." *Id.* (emphasis added). As explained above, the ability to provide video services – and thus obtain an additional revenue stream – is an important part of the business case for the huge investment required to build advanced broadband networks. And to the extent LFAs make it more difficult for a provider to realize that additional revenue stream, they also make it much less likely that the provider will invest in these networks in the first place. Therefore, the Commission must follow Section 706's directive that it remove this barrier to infrastructure investment by precluding this expansive view of the power granted to an LFA.

Finally, confirming that the definition of "cable system" is limited by its express terms would help avoid raising the First Amendment concerns discussed above. Therefore, the Commission should recognize that the term "cable system" does not apply to the entirety of a mixed-use broadband network deployed pursuant to the telecommunications laws, and should

[52] Section 706 of the 1996 Act, Pub. L. No. 104-104, 110 Stat. 56. The 1996 Act defines "advanced telecommunications capability" "without regard to any transmission media or technology, as high-speed, switched, broadband telecommunications capability that enables users to originate and receive high-quality voice, data, graphics, and video telecommunications using any technology." (*Id.* § 706(c)(1).) *See also* 47 U.S.C. § 230(a)(4) (declaring that Internet and other interactive computer services have flourished "with a minimum of government regulation," and asserting federal policy to preserve them "unfettered by Federal or State regulation").

preempt local governments from exercising authority over the construction, placement or operation of such a network.

B. The Commission Possesses Preemptive Authority To Construe the Act.

As discussed above, the Commission possesses ample authority to adopt a preemptive construction of the "cable system" definition in order to avoid the mischief that some LFAs and incumbents threaten.

First, as discussed above, Section 636 expressly preempts State and local laws that are contrary to federal law. *See* 47 U.S.C. § 556. And this preemptive authority extends to the Commission's interpretations of the Cable Act. For example, in *City of Chicago*, the Seventh Circuit upheld just such an exercise of preemptive authority by the Commission in interpreting this same term. 199 F.3d at 426. In that case, the Commission had interpreted the definition of "cable system" and concluded that an "operator of a satellite master antenna television system (SMATV), is not a 'cable operator' of a 'cable system' . . . and thus [was] not subject to the requirement that it obtain a franchise." *Id.* The court then concluded that it was "not convinced that for some reason the FCC has well-accepted authority under the Act but lacks authority to interpret § [621] and to determine what systems are exempt from franchising requirements." *Id.*

Moreover, as also explained above, Section 253 of the Communications Act expressly preempts municipal attempts to exercise regulatory authority over the construction, placement and operation of these networks. That Section in fact *requires* the Commission to preempt any state or local law that "prohibit[s] or has the effect of prohibiting" the provision of telecommunications service." *Id.* § 253(d). As the Ninth Circuit recently noted, Section 253 was intended to further the "procompetitive, de-regulatory national policy framework" adopted in the

1996 Act,[53] and "restrict[s] municipalities to a 'very limited and proscribed role in the regulation of telecommunications.'" *Id.* at 619. The authority that some LFAs have suggested they might try to exercise over a broadband network would be anything but "limited and proscribed." Therefore, Section 253 requires preemption of these potential municipal efforts.

Finally, as discussed more above, preemption is appropriate in this context so that the Commission can "protect a valid federal regulatory objective" in light of the mixed interstate/intrastate characteristics of these broadband services and facilities. *PSC of Maryland v. FCC*, 909 F.2d 1510, 1515-16 (D.C. Cir. 1990) (citations omitted); *see also* Vonage Order ¶ 19. For similar reasons, the Commission has authority to preempt municipal authority over these broadband networks because allowing intrusive municipal regulatory control over these networks would stand as "an obstacle to the accomplishment and execution of the full objectives of Congress" related to video competition and broadband deployment. *See Louisiana PSC*, 476 U.S. at 369; *Hines v. Davidowitz*, 312 U.S. 52 (1941). And, of course, Section 706 further directs the Commission to exercise its authority to remove regulatory impediments to investments in broadband networks and infrastructure.

[53] Qwest at 617 (quoting Conference Report).

CONCLUSION

Consistent with these comments, the Commission should address and prevent those practices that amount to an unreasonable refusal to award a competitive franchise, as required by Section 621(a). The Commission also should preempt LFAs from exercising regulatory control over the construction, placement, and operation of a mixed-use broadband network constructed pursuant to the federal and state telecommunications laws.

Respectfully submitted,

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February 13, 2006

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Implementation of Section 621(a)(1) of	)	
the Cable Communications Policy Act of	)	MB Docket No. 05-311
1984 as amended by the Cable Television	)	
Consumer Protection and Competition Act	)	
of 1992	)	

DECLARATION OF MARILYN O'CONNELL

1. My name is Marilyn O'Connell. My business address is One Verizon Way, Second Floor, Basking Ridge, NJ, 07920. I am the Senior Vice President of Video Solutions at Verizon. In this capacity, I am responsible for strategy, development, and implementation of Verizon's new fiber-optic television service called FiOS TV. I also am responsible for overseeing Verizon's efforts to obtain local cable franchises in connection with the deployment of FiOS TV over the new fiber-to-the-premises network that Verizon is constructing.

2. The purpose of this declaration is to describe Verizon's experience in trying to enter the video market. Part I provides an overview of Verizon's experience in obtaining cable franchises, including an estimate of the number of cable franchises that Verizon has already sought and plans to seek in the near term; the number of cable franchises that Verizon has already been awarded; the number of local franchising authorities ("LFAs") with whom Verizon is still negotiating; and the average time it has taken Verizon to obtain a franchise, or, where negotiations are still ongoing, the typical duration of those negotiations.

3. Part II describes the specific difficulties Verizon has faced in obtaining cable franchises. These include excessive delays that Verizon has been forced to endure, typically as a result unreasonable LFA demands, or due to an LFA's general inattentiveness in promoting competitive entry; attempts by LFAs to impose excessive geographic build-out requirements; and attempts by LFAs to impose excessive conditions on Verizon's franchise, including, for example, unauthorized fees, unnecessary or duplicative Public, Educational, and Governmental ("PEG") "contributions" or facilities, requirements that Verizon provide communications networks or other tributes unrelated to the provision of video services, and impermissible regulatory authority over non-video services or mixed-use facilities. I also discuss how the franchise process permits self-interested third parties — such as outside consultants and incumbent cable operators — to interfere in the process in an effort to subject Verizon to further delay and expense.

4. Part III discusses some of the difficulties that Verizon has experienced with incumbent cable operators who have refused to deal with Verizon — both with respect to obtaining access to certain programming networks, and also in obtaining access to PEG channels. For example, Verizon has been unable to obtain access to seven programming networks owned in whole or in part by Cablevision's video programming subsidiary, Rainbow Media Holding LLC ("Rainbow"). In particular, with respect to three (satellite-delivered) regional sports networks that are an important part of a competitive channel line-up, Rainbow has refused for over a year even to start negotiations for carriage.

I. OVERVIEW OF VERIZON'S EXPERIENCE IN OBTAINING CABLE FRANCHISES

5. Verizon is in the process of deploying an advanced fiber network, known as FiOS, to 800 communities in 16 states around the country, from New York to California. As of year-end 2005, the FiOS network already passed approximately 3 million homes. By year-end 2006, Verizon expects to pass approximately 6 million homes with FiOS. Verizon has hired between 3,000 and 5,000 employees across the country to help build the new FiOS network.

6. One of the key services that Verizon plans to offer over FiOS is a multi-channel video service — known as FiOS TV — that competes directly with the video services that incumbent cable operators and satellite providers currently offer. We expect FiOS TV to match or exceed cable and satellite in all key respects. Our plan is to offer more digital channels, more high-definition (or HDTV) channels, and more features, all at competitive prices. Customers currently can choose from nearly 400 digital video and music channels, over 20 high definition channels, and 2,000 video-on-demand titles. Verizon's lead offer currently is priced at \$39.95 per month. FiOS TV will also accompany Verizon's industry-leading voice and data services, giving consumers the advantages of the so-called "triple-play" offering.

7. Where Verizon has begun offering FiOS TV service it has proven popular with consumers. For example, in the first market where Verizon began offering this service, Keller, Texas, more than 20 percent of homes to which the service is available have signed up. Moreover, in locations where Verizon has begun offering this service, incumbent cable operators have responded by reducing their prices. According to Banc of America, for example, incumbent cable operators have offered price cuts of 28-42

percent, although they generally have "not actively advertised" these discounts or made them available to areas not served by FiOS TV.[1]

8. Verizon initiated the process of obtaining cable franchises in a number of jurisdictions beginning in mid-2004. During 2005, Verizon conducted franchise negotiations with approximately 320 LFAs. Verizon obtained only 44 franchises as of year-end 2005, and has obtained seven additional franchises so far in 2006. These franchises cover roughly 1.36 million households. Although Verizon has not been able to obtain franchises as quickly as it hoped, Verizon also is concerned that it will face even greater difficulties going forward. For example, 29 of the 51 franchises that Verizon has obtained are in Texas, where recently enacted legislation enabled Verizon quickly to obtain many of these franchises from the Texas PUC.

9. Exhibit 1 contains a list of the jurisdictions that have granted Verizon a franchise, the date that Verizon initiated the franchise process in each jurisdiction, and the date the franchise was ultimately granted. As this list shows, excluding Texas, it has often taken Verizon between 6 and 12 months, and sometimes more, to obtain the franchises that it has been awarded.

10. Verizon is currently in the process of negotiating franchise agreements in more than 300 jurisdictions in 12 states. Verizon also plans to initiate negotiations in approximately 150 additional jurisdictions during the course of 2006. Of the more than 300 franchises that Verizon is negotiating, more than half have dragged on for more

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[1] Bank of America Equity Research, *Battle for the Bundle: Consumer Wireline Services Pricing*, at 10 (Jan. 23, 2006).

than six months, while some have been ongoing for more than a year. Verizon estimates that it will need between 2,000 and 3,500 franchises.

11. In general, the time and cost of obtaining a franchise does not depend on the size or density of the franchise area. Thus, it could be equally or more time consuming and costly for Verizon to obtain a franchise for an area like New Salem, Pennsylvania, which has only about 1,200 households, than it could be to obtain a franchise for an area like Howard County, Maryland, which has more than 90,000 households.

12. Because the application and negotiation process is so time consuming and resource-intensive, Verizon has been required to hire a very large staff just to focus on obtaining franchises. There are currently more than 50 Verizon employees or contractors that are dedicated to obtaining local franchises, and many more Verizon employees who also support this effort. In addition, Verizon has had to retain a number of outside law firms and consultants to assist in this process. In 2006 alone, Verizon has budgeted tens of millions of dollars for the process of obtaining franchises.

13. The time and expense of obtaining a franchise is compounded by the fact that, in some states, local franchises must be reviewed and approved at multiple levels. For example, in New Jersey, municipalities are responsible for adopting "municipal consent ordinances" that include terms and conditions for the franchise,[2] but the

[2] State of New Jersey Board of Public Utilities, Office of Cable Television, *Guide to Franchise Renewal*, (Sept. 2003), available at http://www.bpu.state.nj.us/wwwroot/cable/FranchiseRenewalGuide.pdf; New Jersey Board of Public Utilities, Office of Cable Television, *Cable Description*, available at http://www.bpu.state.nj.us/home/cableDescription.shtml; Board of Public Utilities, Office of Cable Television, *General Laws of New Jersey, Title 14, chapter 18: Regulations of*

ultimate franchise authority is the State's Board of Public Utilities, Office of Cable Television (OCTV).[3] In New York, a locally ranted cable franchise is not effective until it has been "confirmed" by the Public Service Commission.[4] These multi-level processes, even if undertaken expeditiously, automatically add further delay to the process.[5]

II. PROBLEMS WITH THE LOCAL FRANCHISE PROCESS

14. Even assuming that the local franchise process worked smoothly, it would still take Verizon a considerable amount of time to obtain all the franchises it needed. The franchise process does not work smoothly, however, but is instead fraught with needless delay and expense that is caused, in large part, by those LFAs that seek to extract as much as possible as a condition of awarding a franchise.

15. The difficulties that Verizon has experienced can be grouped into several broad categories: (1) excessive delays that Verizon has been forced to endure; (2) attempts by LFAs to impose excessive geographic build-out requirements; and (3)

Cable Television, at § 14:18-1.2 ("Franchising Authority"), 14:18-11.1-12.1 (May 10, 2005), available at http://www.bpu.state.nj.us/wwwroot/secretary/njac14_18_20050510.pdf.

[3] New Jersey Cable Television Act, N.J.S.A. 48:5A-1 et seq.

[4] New York State Public Service Commission, The Cable Municipal Assistance Section, available at http://www.dps.state.ny.us/CableMuniAssistSection.htm; General Laws of New York, Public Service Law, § 211, Article 11, available at http://public.leginfo.state.ny.us/menugetf.cgi?COMMONQUERY=LAWS; see generally General Laws of New York, PBS — Public Service, Article 11, available at http://public.leginfo.state.ny.us/menugetf.cgi?COMMONQUERY=LAWS.

[5] *See* Order and Certificate of Confirmation, Case 05-V-1263, Petition of Verizon New York Inc. for a Certificate of Confirmation for its Franchise with the Village of Massapequa Park, Nassau County, at 23 (NYPSC Dec. 15, 2005) (approving Verizon's first cable franchise in New York — in Massapequa Park —nearly two months after LFA approval).

attempts by LFAs to impose other excessive conditions on Verizon's franchise. In addition, these problems are exacerbated by the fact that the franchise process permits third parties who have an economic interest in imposing further delay and expense on new entrants like Verizon — such as outside consultants and incumbent cable operators — to interfere in franchise proceedings in order to bring about this result.

A. Excessive Delays In Awarding Franchises

16. After Verizon initiates the franchise process, an LFA typically responds by providing a list of demands. Verizon and the LFA then negotiate over that list. The more unreasonable conditions those initial lists contain, the longer negotiations typically take. Put differently, in order for Verizon to obtain a franchise quickly, it must generally accede to most or all of the LFA's initial demands — whether or not those demands are reasonable. If Verizon does not agree to those demands, LFAs can and do use delay to strengthen their bargaining position. In addition, sometimes delay results from convoluted franchising procedures or bureaucratic inattentiveness, or from the tactics of cable incumbents.

17. As a result of these difficulties, as described in Part I above, Verizon has obtained a relatively small number of franchises thus far, despite devoting enormous resources to the process. The franchises that Verizon has obtained generally have taken Verizon between 6 and 12 months, and sometimes more, to secure. More than half of the franchise negotiations in which Verizon is still involved have been ongoing for more than six months, while some have been ongoing for more than a year. The following are examples of unreasonable delays in the franchise process.

18. In one Virginia community, Verizon initiated negotiations in July 2004. By November 2004, Verizon had negotiated a final franchise agreement with the town attorney, establishing a timeline for notice, commission, and council review, with a tentative final vote date of February 22, 2005. Verizon filed its franchise application with the town on December 6, 2004, and ten days later a notice for public hearings was published. The Town Council met to discuss the agreement on December 13, 2004, and referred the agreement to the Town Cable Commission. The Town Cable Commission demanded significant changes to the negotiated agreement and hired an outside attorney. During this same period, the council dismissed the town attorney. That review resulted in re-starting negotiations virtually from scratch. Negotiations continued until November, 2005, at which point the town dismissed their outside attorney. The town's new attorney has now taken over (its third used during this process), and in the first session, she has demanded to re-start negotiations essentially from scratch. The town attorney said the town isn't sure they are "interested" in having a second cable franchise.

19. Franchise negotiations in another Virginia community also have dragged on for 17 months, with Verizon and the LFA still far apart. Verizon initiated these negotiations in August 2004. At the time, the LFA provided Verizon with an extensive list of demands (see below). After Verizon rejected these demands, negotiations moved at a glacial pace, although some progress has been made recently in the face of franchising reform legislation in Virginia.

20. In one California community, when Verizon approached the LFA in November 2004, it was told that it would be required simultaneously to negotiate with

three other nearby LFAs as a consortium. Verizon eventually acceded to this request in August 2005, and was unable to obtain the consortium's initial list of demands until after it did so. On January 11, 2006, the consortium's counsel told Verizon that they had rejected Verizon's model agreement, that Verizon would be required to pay a $25,000 application fee, and that they wanted to use the *final* agreement Verizon negotiated with Fairfax County, Virginia as the *starting* point for negotiations. The consortium also forwarded to Verizon a long list of demands, including that Verizon provide cable services to large parts of these communities that fall outside of Verizon's telephone service area and in which Verizon has no facilities. Verizon still is negotiating this point, and despite a written demand to the contrary, consortium representatives now are suggesting that they may be willing to compromise on their demand that Verizon build out-of-franchise *so long as* Verizon accedes to other (unacceptable) demands.

21. In one county in Florida, LFA staff required Verizon to file various versions of its franchise application, demanding additional detail and concessions each time before they would submit Verizon's application to the county board for approval *to initiate* negotiations. Verizon's original application was filed in November, 2004, and the county board did not authorize negotiations until a year later. Verizon has only just begun substantive negotiations with staff.

22. In another community in California, Verizon provided a draft franchise application in November 2004. Verizon did not receive a list of initial demands from the LFA until July 2005. That list was so extensive that it stalled negotiations for many

months. In January 2006, the LFA finally indicated that they would reconsider their position on some of the demands in their July 2005 list.

B. Excessive Geographic Build-Out Requirements

23. Some LFAs are demanding, as a condition for awarding a franchise, that Verizon build out its network and provide cable service to areas outside the geographic boundaries of Verizon's choosing. Verizon plans to deploy FiOS in areas where it makes economic sense, given various marketplace dynamics such as consumer demand, competition from cable, or other local factors that affect the cost of deployment. Where Verizon deploys FiOS, it typically builds out an entire wire center and makes service available to customers throughout the area served by that wire center, without regard to political boundaries or neighborhood. On the other hand, with the exception of a limited number of "greenfield" situations, Verizon has not deployed its FiOS network in areas outside of its local telephone service area where it has no facilities and deployment in those areas would be uneconomical.

24. As noted above in Part I, Verizon already has plans to deploy FiOS to a very large portion of its local telephone service territory. Some LFAs have nonetheless demanded that Verizon deploy FiOS throughout their community, regardless of whether it would require Verizon to deploy FiOS beyond its planned wire-center deployment, and regardless of whether Verizon even provides local telephone service throughout that area. Given Verizon's network architecture, such requirements could make deployment uneconomical, by forcing Verizon to build facilities outside of its service area or to convert wire centers to FTTP when it had not planned to do so. And these problems can be compounded by the fact that many wire centers may serve

customers in multiple political subdivisions. If each of those communities sought to impose similar build-out obligations — and they often have — the costs could increase exponentially, making entry uneconomic in many areas. The following are examples of LFA demands for excessive geographic build-out requirements of this sort.

25. One county in Virginia has rejected Verizon's proposed density limitation of 30 homes per linear mile, requiring instead that Verizon abide by a lower 20 homes per linear mile limitation. The added construction cost associated with a change from 30 homes to 20 homes would increase total costs by 50 percent over the costs of building to an area with 30-home density. This would add approximately $20 million to Verizon's build-out costs in this particular county.

26. In one town in Texas, the LFA demanded (prior to the Texas legislation) that Verizon serve the entire franchise territory. Although Verizon agreed to serve approximately 97-98 percent, the LFA rejected this offer and terminated negotiations with Verizon for over a year.

27. As noted above, some LFAs in California have taken the position that the State's limited "level playing field" statute, which contains a so-called "wire and serve" requirement, mandates that Verizon build out to the incumbent's entire franchise area, despite the fact that Verizon's telephone service area does not cover much of the same area.

C. Attempts by LFAs To Extract Excessive Fees or Impose Unreasonable Terms Unrelated to the Provision of Cable Service

28. Verizon frequently has received demands by LFAs for large monetary payments or other types of in-kind contributions as a condition of receiving a franchise.

Even though Verizon has made clear that it will pay franchise fees and provide reasonable PEG capacity consistent with the terms of the Cable Act, franchising authorities nonetheless go much further and demand any number of things. These demands come in five main varieties: (1) payments for "support" of PEG channels; (2) excessive application, acceptance, or processing fees; (3) reimbursement of LFA consultant and attorneys fees; (4) payments or in-kind contributions that are designed to force Verizon to construct communications networks or to subsidize various other municipal projects or initiatives that are unrelated to Verizon's proposed video operations; and (5) attempts to regulate the design and construction of Verizon's FiOS network and non-cable services provided over that network.

1. LFA Demands for Excessive "PEG Support"

29. A number of LFAs have sought excessive fees to support PEG channels. LFAs typically require Verizon to provide, at a minimum, the same PEG support as the incumbent, despite the fact that matching the incumbent would enrich the LFA far beyond what it needs to support its PEG channels and programming. In the vast majority of cases, the facilities and equipment needed to develop and transmit PEG programming have already been deployed, and are not even being used to their capacity. In Verizon's experience, LFAs do not make a showing to Verizon that they need additional PEG support beyond the levels they already receive. And there is no reason to presume that Verizon's entry would increase the amount of PEG programming that is required or the costs of producing this programming. In some cases, LFAs have not only required Verizon to match the PEG support that the

incumbent provides, but also have required Verizon to provide even greater levels of support.

30. For example, one franchising authority in Florida demanded that Verizon match the incumbent cable operator's cumulative PEG payments, which would exceed $6 million over the 15-year term of Verizon's proposed franchise. When Verizon rejected this demand, the LFA doubled its request, asking for a fee in excess of $13 million for both PEG and the construction of a communications network. The LFA claimed this was based on a back-of-the-envelope "needs assessment." Verizon rejected the demand and the LFA went back to its original $6 million dollar demand. Negotiations with this LFA are still ongoing.

31. One California community initially demanded that Verizon match the PEG support that the incumbent has made over time. This included up-front charges of more than $500,000 for PEG access equipment and facilities, and revolving charges that bring the total up to approximately $1.7 million.

32. Many franchising authorities in one metropolitan area charge 3 percent for PEG support on top of the five percent franchise fee. These LFAs do not attempt to show that this support is needed for PEG uses, nor are these additional fees treated by the LFAs as chargeable against the federal 5-percent franchise fee cap.

33. Some franchising authorities are demanding that Verizon provide greater PEG capacity and support than the incumbent provides. For example, one community in Massachusetts has demanded that Verizon set aside 10 PEG channels, while the incumbent provides only two. Another town in Massachusetts has demanded that Verizon provide PEG support payments that exceed what the incumbent is required to

provide. This town has required Verizon to provide a franchise fee equal to 5 percent of gross revenues, compared to only 3 percent paid by the incumbent, and a performance bond that is twice as high as the incumbent.

2. Excessive Application, Acceptance, or Processing Fees

34. Just like businesses that seek to conceal the true price of their products by tacking on excessive "processing" or "shipping and handling" fees, LFAs frequently demand excessive application or processing fees over and above the 5-percent franchise fees they are authorized to collect under federal law. These fees are given various names — such as application fees or acceptance fees — but regardless of what they are called, they have the same effect, which is to require Verizon to hand over a large sum of money as a condition of initiating or continuing the franchise process. The following are examples of these unreasonable requests.

35. In Virginia, many LFAs require "acceptance fees" at the time Verizon is awarded a franchise. One LFA required Verizon to pay $225,000; another required $50,000; a third also required $50,000; and a fourth required $100,000. Two other Virginia LFAs required application fees — which are paid at the time Verizon files the application — of $10,000 and $50,000, respectively.

36. Two LFAs in California required application fees of $25,000 and $20,000, respectively. Another community in that state has requested an upfront application fee of $30,000 plus an agreement to pay additional expenses (*i.e.,* attorneys fees) of up to an additional $20,000. Two LFAs in Pennsylvania required $30,000 and $50,000 application fees, respectively. A major Maryland LFA required a $25,000 application fee to begin the negotiation process.

3. LFA Demands for Excessive Attorneys and Consultant Fees

37. A number of LFAs have demanded that Verizon pay for the consultants or attorneys hired by the municipality to negotiate on its behalf. In many cases, the only reason these consultants or attorneys are needed in the first place is because the LFA wants to extract from Verizon as many concessions as possible. If the LFA were interested in introducing video competition quickly, they could probably handle most or all of the job in house, or with minimal outside assistance. Indeed, some LFAs both large and small (Fairfax County and the City of Fairfax, Virginia, for example) have done just that. Other LFAs, however, have brought in outside firms whose main purpose and expertise is to extract as much value from the franchise applicant as possible, without regard to the costs such practices have on the viability of competitive entry or the delays that result. Indeed, because these firms typically are paid by the hour (as indicated by the bills that Verizon receives from these LFAs), their incentives are to delay the franchise process as much as possible, which is completely contrary to the interests of consumers at large. Moreover, some LFAs hire separate attorneys at different stages, which means Verizon is required to pay multiple layers of fees — for example, first for the attorneys used to negotiate the franchise, and second for the attorneys used in the approval process. The following are examples of LFA demands for excessive attorneys and consultants fees.

38. One Virginia LFA demanded that Verizon pay its attorneys fees for its outside law firm, who advises and negotiates the franchise on behalf of the county. As part of negotiations with this LFA, Verizon ultimately agreed to pay attorneys' fees up to a cap ($75,000), which the firm now has exceeded. The LFA, quoting its self-

enacted cable ordinance, has indicated that it expects Verizon to pay the additional fees as well.

39. A major Maryland LFA is demanding that Verizon pay its expenses and attorneys fees, and it also has passed an ordinance to that effect. Verizon expects these fees to be excessive, in part because Verizon first would be required to pay the fees of attorneys retained by the county executive to assist in negotiating the agreement, and then, once the agreement is submitted to the county Council for approval, would be required to pay the Council's separate attorney fees.

40. A small Virginia LFA demanded that Verizon pay (and Verizon has paid) $30,000 so far to compensate an outside attorney. This LFA has already dismissed two attorneys with whom Verizon has negotiated, thus prompting negotiations to essentially start over from scratch, now for the third time.

4. LFA Demands for Communications Networks and Other Compensation Unrelated to the Video Franchise

41. Verizon also has received many demands from LFAs that are completely unrelated to its video operations. In a number of cases, LFAs have made demands designed to have Verizon provide extensive communications networks or facilities — referred to by some LFAs as "institutional" networks — or to subsidize some other municipal pet project or policy initiative.

42. In one Massachusetts community, the LFA initially demanded that Verizon provide funds for the town to purchase street lights from a third party owner; install cell phone repeaters at town hall; provide subsidized cell phones and service to town employees; wire all houses of worship; provide free Internet to all town buildings;

and make parking available at Verizon's downtown facility for patrons of the public library. Another city in Massachusetts requested that Verizon provide dark fiber to all public buildings in the franchise.

43. A Virginia county initially demanded that Verizon connect 220 traffic signals in the county with fiber; provide fiber services to "approximately 60" organizations "who work with the [LFA's] Department of Human Services to provide medical, psychological, educational, nutritional, employment and housing assistance to at risk segments of the community"; provide high-speed cell phones for "approximately 1000 employees"; provide discounted broadband access in public housing; and allow the county free use of Verizon manholes, conduits and utility poles. After more than a year of negotiations, the county agreed to drop some of these demands.

44. Another Virginia LFA has demanded that Verizon provide eight-strand dark fiber to all public buildings, even though all of these buildings already are wired with fiber. Verizon estimates that the price for providing these facilities to an ordinary retail customer would be approximately $2.3 million.

45. One LFA in Pennsylvania demanded that Verizon provide free wireless broadband service (via EvDO) to local police, even though the incumbent faces no such requirement. Nor is wireless broadband provided by Verizon's Pennsylvania subsidiary that is seeking the franchise. The LFA also demanded that Verizon provide free high-speed Internet access to the town's two municipal buildings.

46. A city in California initially demanded that Verizon provide free Internet access at public facilities; that Verizon maintain at no cost the city's existing fiber optic

cable to all city locations; and that Verizon provide data transmission facilities to various public schools.

47. During preliminary franchise discussions, officials in one New Jersey community suggested that they would "like" free or reduced-fee broadband Internet service for municipal employees in return for awarding a franchise. They also requested free Internet access for public schools, and free connections for security cameras the town is placing on poles. The officials suggested that, if Verizon agreed to these conditions, they might reduce the amount of PEG support that Verizon would be required to provide, confirming that such PEG support is not required in the first place.

48. A number of LFAs in New York have demanded free broadband Internet access for municipal locations.

5. *Attempts by LFAs To Regulate the Design and Construction of Verizon's FiOS Network and Non-Cable Services Provided Over That Network*

49. Some municipalities are asserting that Verizon's provision of video service in their territories grants them authority to regulate the design or construction of the FiOS network, or allows them to collect franchise fees on Internet and telephony services provided over the network. Other municipalities have sought to regulate Verizon's construction of the FTTP network *prior* to the build out. While some LFAs have made specific demands along these lines, others have threatened to do so.

50. Before describing these problems in greater detail and providing specific examples that Verizon has experienced to date, it is important to note that while these problems would make entry extremely difficult and costly if imposed uniformly on Verizon, they are compounded by the fact that each LFA typically imposes a unique set

of conditions, thereby requiring Verizon to make system-by-system adjustments that reduce the efficiencies of planning and operating on a region-wide or national basis. Verizon's significant scale is one of the key reasons it believes it can succeed in the video market. But this scale is compromised if Verizon is required to operate different types of systems in different localities, which is what would occur if LFAs were permitted to have their way. The following are examples of this conduct.

51. A major Maryland LFA is demanding, as a condition for securing a franchise, that Verizon allow the LFA to regulate non-cable services that are subject to exclusive FCC jurisdiction.

52. In Pennsylvania, numerous municipalities are claiming that they are entitled to 5 percent of Verizon's future voice and data revenues from FiOS, in addition to a 5 percent cable franchise fee.

53. In a filing before the New York PSC, the towns of Larchmont and Mamaroneck asserted that once Verizon has a franchise, they will have regulatory authority to require Verizon to "entirely rebuild" its system, regardless of the impact on Verizon and despite Verizon's independent authority under federal and state telecommunications laws to deploy its network.

54. A Maryland LFA is demanding that Verizon obtain a franchise prior to issuing any permits for the company to begin FiOS construction.

55. One community in Virginia is refusing to give Verizon permits for fiber deployment, demanding that Verizon bury the fiber at a cost of $3-4 million.

D. The Franchise Process Permits Self-Interested Third Parties — Such As Outside Consultants And Incumbent Cable Operators — To Interfere In The Process In An Effort To Subject Verizon To Further Delay And Expense

56. Although the franchise process is burdensome in and of itself, the problems that Verizon has faced have been compounded by the fact that the process permits self-interested third parties — such as outside consultants and incumbent cable operators — to interfere in the process in an effort to subject Verizon to further delay and expense. As noted above, LFAs often hire outside consultants to help negotiate on their behalf, and it is in these consultants' economic interest to drag on negotiations for as long as possible because they are typically paid by the hour. Moreover, it is typically the franchise applicant — that is, Verizon — who is forced to pay the consultant fees, which provides even greater incentives for the consultant to drive up fees as high as possible.

57. For example, one consultant in Pennsylvania has convinced several municipalities to demand franchise fees based on the telephone and Internet access revenue derived from FTTP. Interestingly, the same consultant convinced several of these same communities to adopt ordinances requiring that a franchise applicant pay the LFAs' consultants fees.

58. The franchise process also is susceptible to influence from incumbent cable operators, who are likewise interested in imposing maximum delay and expense on Verizon in order to improve their own competitive position. The following are examples of cable-erected roadblocks in the franchise process.

59. Cable operators have filed lawsuits against municipalities to stop them from awarding franchises to Verizon. On September 26, 2005, the Village of Massapequa Park ("Massapequa Park" or the "Village") on Long Island became the first local franchising authority in New York to approve the issuance of a cable franchise to Verizon. On October 16, 2005, Cablevision — the incumbent cable provider in Massapequa Park — brought suit against the Village and Verizon alleging that, in approving Verizon's franchise, the Village had violated the New York Open Meetings Law, N.Y. Public Officers Law §§ 100 *et seq.* In what appeared to be an attempt to intimidate the Village officials, Cablevision also sought to depose the Mayor and the Village Trustees that had just granted the franchise. The Cablevision lawsuit is premised not on the merits of Verizon's franchise, but rather on Cablevision's assertions that the Village Board of Trustees violated the Open Meetings Law by conducting several "private" meetings to discuss Verizon's proposal before the Verizon franchise was approved. Cablevision failed to provide the Court with a transcript of the five-hour public hearing spanning two days that preceded the Village's approval, which reflects that numerous comments were submitted by Cablevision representatives during the review process, acted upon by the Village and incorporated in the Verizon franchise. Furthermore, in sworn statements submitted in support of the Village's motion to dismiss, the Mayor, each Village Trustee, the Village Administrator and the Village Attorney have filed affirmations rejecting each and every claim asserted by Cablevision. On January 23, 2006, the court rejected Cablevision's claims, but Cablevision has indicated that it may appeal.

60. Cable operators have threatened litigation with several other municipalities, often premised on alleged violations of so-called "level playing field" requirements. Charter made threats to LFAs in Keller, Texas, and Adelphia made threats in Leesburg, Virginia. Other cable operators have sent other municipalities threatening materials (often before Verizon even submits a franchise application) warning them of a battle ahead (*e.g.*, Cablevision in New York and Comcast in Texas). These actions already appear to be having a chilling effect on other local franchise authorities, whose representatives have expressed concern about commencing the franchise process out of fear of having to engage in costly litigation down the road.[6] Moreover, these tactics have led several LFAs to request that Verizon agree to indemnify them if incumbents cable operators bring suit.

61. In Massapequa Park, cable-backed groups have distributed false and misleading flyers and advertisements to residents claiming that Verizon's new network facilities are "eyesores" that "can block your vision" and will diminish "your property values and the beauty of your neighborhood." Cable companies have threatened town mayors that they would distribute these flyers unless public hearings on Verizon's franchise application were postponed.

62. Cable operators also have slowed the franchise process by demanding the opportunity to review Verizon's proprietary information, including actual dates of construction, services to be delivered, maps of service areas, and pricing information.

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[6] *See* D. Searcey, *Spotty Reception: As Verizon Enters Cable Business, It Faces Local Static*, Wall St. J. at 1 (Oct. 28, 2005) ("[Tampa] City officials began worrying about lawsuits from the cable company. They demanded Verizon include a clause in its franchise agreeing to pick up the tab for any lawsuits related to the deal. Verizon refused.").

Verizon has been forced to bring legal actions to prevent LFAs from disclosing Verizon's draft franchise agreements, which often are required to contain these kinds of proprietary information, from being disclosed to cable operators.

63. In Howard County, Maryland, where Verizon recently obtained a franchise, Comcast made an intense eleventh-hour push to delay the council from approving the franchise until Verizon agreed to a long list of additional conditions.

III. INCUMBENT CABLE OPERATORS' REFUSAL TO DEAL WITH VERIZON

64. Verizon's difficulties with incumbent cable operators have not stopped with the franchise process. One major cable operator has prevented Verizon from gaining access to programming they own or control, while other cable operators have prevented Verizon from obtaining interconnection to their PEG channels.

65. Verizon's main problems with obtaining access to video programming services have involved Rainbow, a wholly wned subsidiary of Cablevision with interests in national and regional cable television programming networks. Beginning in 2004, and continuing throughout 2005 and 2006, Verizon has attempted to negotiate with Rainbow to obtain access to seven of Rainbow's satellite-delivered cable programming networks — four national cable networks (AMC, The Independent Film Channel (IFC), WE: Women's Entertainment, and fuse, all 100% Cablevision-owned); and three regional sports networks (FSN New York and MSG, both 100% Cablevision-owned, and FSN New England, 50% Cablevision-owned). Each of these networks is satellite-delivered, and Rainbow is providing them to other MVPD providers (including both DBS operators) who operate in the New York area.

66. Beginning in mid-2004, Verizon reached out to Rainbow to begin discussions regarding carriage of its networks. In February 2005, Verizon again initiated contact with Rainbow, indicating that Verizon would like to enter into an affiliation agreement with Rainbow specifically for three of its regional sports networks. Rainbow indicated they would be back in touch. Over the next several months, there were several phone calls between Verizon and Rainbow, but Rainbow failed to provide Verizon with an agreement from which to negotiate or even a formal carriage proposal for the regional sports networks.

67. Meanwhile, during the late spring and summer of 2005, Verizon negotiated with Rainbow regarding carriage of AMC. As of mid-July, Verizon believed that the AMC agreement would soon be ready to sign and would thereafter serve as the template agreement for the other Rainbow networks. On August 12, 2005, however, Rainbow circulated a revised draft with a new provision that required Verizon to obtain valid "local" franchises as a condition of carriage of AMC, as opposed to the original drafts that merely required franchise approval from the "appropriate governmental authority." In conjunction with the new "local" franchise language, Rainbow's draft also included an additional sentence suggesting that if statewide franchise legislation applicable to Verizon were to be subsequently enacted, Verizon would be required to continue to adhere to the terms of the original local franchise agreement in order to avoid being in breach of the AMC agreement. The timing of Rainbow's action did not appear to be accidental — two days before Rainbow sent its new terms to Verizon, the Texas Legislature had passed legislation to enable video service providers to obtain a single state-level cable franchise. Rainbow's action came

as a surprise to Verizon because none of the other numerous video programming agreements that Verizon had negotiated had included the language or concepts that Rainbow was now trying to introduce.

68. Ten days after receiving Rainbow's new local franchise language, Verizon sent back a revised agreement for AMC that removed the "local" franchise requirement and offered alternative language. On September 16, 2005, Rainbow responded with a counterproposal that rejected Verizon's alternative language. The counterproposal provided that, if state legislation is enacted that replaces the local franchise applicable to Verizon with an applicable statewide franchise, Verizon's right to continue distributing AMC shall "require the written consent of [Rainbow], which [Rainbow] may provide or withhold in its sole discretion." On September 22, 2005, Verizon launched FiOS TV in its first market (Keller, TX), and, because Rainbow refused to move forward unless Verizon agreed to its proposal, Verizon was forced to go to market without AMC or the other Rainbow networks, such as IFC and WE.

69. While negotiations regarding AMC were taking place, Verizon continued its efforts to obtain access to the three regional sports networks. In the summer of 2005, the employees at Rainbow with whom Verizon had been negotiating informed Verizon that they could not continue to pursue discussions and that there would need to be a higher-level "corporate" decision. Representatives of FSN New England similarly told Verizon that they were not empowered to continue conversations. In October 2005, a senior executive at Rainbow, told Verizon that MSG and FSN New York would not make any proposal to Verizon unless Rainbow was told the specifics of where and when Verizon plans to launch its FiOS TV service.

70. Verizon promptly provided Rainbow with information about Verizon's launch plans for FiOS TV. After multiple attempts to follow-up, Verizon finally reached the Rainbow senior executive in early December 2005. The executive stated for the first time that a regional sports programming contract between Rainbow and Verizon would need to contain the same local franchising provision that Rainbow had proposed for the AMC agreement.

71. On December 15, 2005, Rainbow sent Verizon a revised AMC agreement that removed Rainbow's local franchising language but incorporated a new "Verizon-Rainbow Carriage Proposal" that linked carriage of AMC (as well as WE and IFC) to carriage of three additional Cablevision-owned programming networks — VOOM, Mag Rack, and *sportskool*.[7] Under the proposal, (1) Verizon would be required to place VOOM on its basic or expanded basic tier so that VOOM "is received by at least 90% of each covered system's subscribers," even though VOOM consists of high-definition channels that can be enjoyed only by the minority of TV viewers with HDTV-compatible sets, and (2) Cablevision's proposed price for VOOM was $4.85 per basic subscriber per month — much more than popular cable networks generally command.[8] EchoStar, which is a part-owner of VOOM and the only MVPD other than Cablevision to carry VOOM thus far, offers the service on a stand-alone basis — that

[7] Mag Rack and *sportskool* are 100% Cablevision-owned; VOOM is 80% Cablevision-owned, with the other 20% controlled by EchoStar.

[8] ESPN, which is the most expensive satellite-delivered national programming network, typically charges between $2.50 and $2.80 per subscriber per month, while other top-ten networks (such as CNN and USA) charge a fraction of that (e.g., $0.40-$0.60 for CNN and $0.80 for USA). *See* T. Lowry, *et al.*, *In the Zone*, Business Week (Oct. 17, 2005) (citing Morgan Stanley estimates); R.T. Umstead, *Fox News: Fair, Balanced, and Pricey*, Multichannel News at 6 (Oct. 31, 2005).

is, for sale outside the basic or expanded basic tier — for an additional $5 per subscriber per month. Despite repeated efforts, Verizon has been unable to discuss this latest carriage proposal with Rainbow.

72. In early January 2006, with launches of FiOS TV approaching in Woburn, Massachusetts and Massapequa Park, New York, Verizon began a series of daily phone calls trying to reach Rainbow's senior executive to discuss access to its regional sports networks. The Rainbow executive did not return those calls. Verizon finally reached the executive on January 10. The executive stated he would get back to Verizon shortly on next steps with respect to the regional sports networks. Rainbow has not yet done so.

73. As an alternative to negotiating with Rainbow directly for its services, Verizon attempted to secure the programming through the National Cable Television Cooperative or NCTC, a cable programming buying cooperative that represents more than 1,000 cable operators that serve more than 14 million subscribers.[9] NCTC negotiates and administers agreements with cable programming networks on behalf of its members. Verizon is an NCTC member in good standing. Although Verizon secures programming for approximately 30 other cable networks via the NCTC, Rainbow verbally informed Verizon that it would refuse to give its approval if Verizon attempted to move forward with such an arrangement. Typically, the only reason a programmer would deny an NCTC member access to programming via the NCTC would be in the event that the member was not in good standing or was otherwise in

[9] *See* National Cable Television Cooperative, *What Is the NCTC?,* http://www.nctc.coop/membership_benefits.asp.

breach of a separate agreement with the programmer. Neither of these NCTC denial justifications could be asserted by Rainbow against Verizon. Verizon asked Rainbow to put its position in writing, and a Rainbow Vice President said she would send Verizon a letter to this effect. But despite repeated requests, Rainbow has refused to send such a letter.

74. As of the date of this declaration, Verizon continues to try and negotiate carriage agreements with Rainbow, but still does not carry any of the Rainbow programming networks, including the regional sports networks, in any of its six FiOS TV markets.

75. Another practice engaged in by some cable incumbents is refusal to interconnect for purposes of transmitting a municipality's PEG channels to Verizon. Instead, some incumbents have tried to force Verizon to incur substantial expense to acquire these PEG channels — channels that it is forced to carry by LFAs in the first place — through other means. And incumbents have even forced this unnecessary expense in Texas, where the recent legislation specifically required them to interconnect for purposes of transmitting PEG signals. The refusal to interconnect under these circumstances increases Verizon's costs of entering the market.

I declare, under penalty of perjury, that the foregoing is true and correct.

Marilyn O'Connell

Marilyn O'Connell

February 13, 2006

COMPLETED FRANCHISES			
Local Franchise Authority	**Franchise Awarded**	**Process Started***	**Duration (approx.)**
Beaumont, CA	2-Nov-04	Jun-04	5 months
Sachse, TX	6-Dec-04	Jul-04	5 months
Wylie, TX	25-Jan-05	Jul-04	6 months
Keller, TX	1-Feb-05	Apr-04	9 months
Westlake, TX	3-Feb-05	May-04	8 months
Quantico MCB, VA	4-Apr-05	Jan-05	3 months
Ft. Belvoir, VA	Apr-05	Jan-05	3 months
Temple Terrace, FL	17-May-05	Sep-04	8 months
Herndon, VA	19-Jul-05	Sep-04	10 months
Manatee County, FL	30-Aug-05	Oct-04	10 months
Murietta, CA	6-Sep-05	Feb-05	7 months
Fairfax County, VA	26-Sep-05	Mar-05	6 months
Massapequa Park, NY	14-Dec-05	Jul-05	5 months
City of Fairfax, VA	27-Sep-05	Jul-05	2 months
Woburn, MA	29-Sep-05	Jan-05	9 months
Allen, Carrollton, Colleyville, Coppell, Denton, Double Oak, Flower Mound, Fort Worth, Garland, Grapevine, Hebron, Highland Village, Irving, Lewisville, Lucas, Murphy, Parker, Plano, Rowlett, Southlake, St. Paul, TX (21 LFAs)	State-issued franchise granted by PSC October 21, 2005	State-issued franchise application submitted September 30, 2005	3 weeks
Tarrant, Denton, Dallas, Collin Counties, TX (unincorporated counties)	N/A	N/A	N/A
Apple Valley, CA	8-Nov-05	Apr-05	8 months
Nyack, NY	8-Feb-06	Nov-04	15 months
South Nyack, NY	8-Feb-06	Nov-04	15 months
Bellefonte, DE	12-Dec-05	27-Oct-05	1 month
Howard County, MD	3-Jan-06	5-May-05	8 months
Hermosa Beach, FL	10-Jan-06	10-Mar-05	10 months
Falls Church, VA	23-Jan-06	1-Sep-04	17 months
Reading, MA	25-Jan-06	9-Aug-05	6 months
Hillsborough County, FL.	1-Feb-06	12-Apr-05	10 months
Hulmeville, PA	6-Feb-06	30-Sep-05	4 months
Bradenton, FL	08-Feb-06	20-May-05	9 months

*Reflects date on which Verizon initiated franchise discussions with LFA.

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:	)	
	)	
Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as Amended by the Cable Television Consumer Protection and Competition Act of 1992	)	MB Docket No. 05-311
	)	

DECLARATION OF THOMAS W. HAZLETT

1. I am Professor of Law & Economics at George Mason University, where I also serve as Director of the Information Economy Project of the National Center for Technology & Law. I previously served as Chief Economist of the Federal Communications Commission in 1991-92, and have also held faculty positions at the University of California, Davis, Columbia University, and the Wharton School. I have written extensively on the economics of cable TV markets, including municipal franchising. I am the co-author of Public Policy Toward Cable Television (MIT Press, 1997), and the author of "Cable Television," Chapter 6 in Martin Cave, et al., eds., Handbook of Telecommunications Economics, Vol. II (North Holland, 2005). I also serve as Senior Advisor to the Analysis Group, which has assisted me in preparing this declaration. My C.V. is Exhibit 2.

2. I submit this Declaration at the request of Verizon. In particular, I have been asked to discuss how certain practices associated with the cable franchising process affect new entrants and consumers from an economic perspective.

3. I conclude that there are numerous practices associated with the existing cable franchising process that are unreasonable and that impose substantial barriers to entry. These barriers are an obstacle to achieving greater competition in the provision of multi-channel video service. This competition has been shown to lower quality-adjusted prices by 15% or more.[1] By denying consumers the benefits of this competition, these unreasonable franchising practices impose significant costs. These costs are unnecessary, particularly for entrants that already have authority to use public rights-of-way. Given that consumer gains from nationwide video competition are projected to be on the order of $76 billion to $134 billion, removing franchising-related roadblocks that resulted in accelerating nationwide wireline competition in video would realize potential consumer benefits of $16 billion to $28 billion.[2]

4. This Declaration details this analysis in three parts. Section I outlines the unreasonable franchise practices that act as barriers to competitive entry. Section II describes why these practices are unnecessary and considers alternative rules that would improve efficiency, reducing prices to consumers. Section III then examines the cost of these unreasonable practices on new entrants and consumers and quantifies the cost savings estimated to result from implementation of pro-competitive reforms.

[1] *See* Exhibit 1.
[2] *See* Exhibit 1.

I. BARRIERS TO ENTRY ERECTED BY UNREASONABLE FRANCHISING PRACTICES

5. In order to offer cable service to households, firms must (under rules dating to the 1984 Cable Act) obtain municipal cable TV franchises.[3] Despite attempts by federal agencies and Congress to facilitate video competition, municipalities treat requests for new entry as applications that must be processed, evaluated, and considered in light of various public policy objectives. This process gives rise to a number of practices that erect substantial barriers to entry. From an economic perspective, these practices are transaction costs that tax potential new investments in competitive facilities.

6. As an initial matter, it is important to recognize that franchise agreements are complex, that they carry important financial implications for potential entrants, and that a very large number of municipalities require such franchises be obtained for substantial regional or national network competition to commence. These factors create a situation where rapid and widespread competitive entry is nearly impossible, even under the best of circumstances.

7. There are tens of thousands of U.S. municipal franchising authorities. Because each authority has the ability to impose costly regulations on a new provider, it is necessary for the potential entrant to engage in bargaining to set the effective level of taxation. This process is expensive to the entrant, often deterring competition for months or years, or in some cases preventing entry altogether. Indeed, overbuilders (the name

[3] Cable Communications Policy Act of 1984, Pub. L. No. 98-549, § 621, 98 Stat. 2779, 2786-2787 (1984).

given competitive wireline entrants in cable TV markets) offer service to only about 5% of U.S. households.[4]

8. In general, the cable franchising process is often characterized by: (a) delays in awarding franchises; and (b) anti-competitive franchise regulations, including build-out requirements. These act as significant entry barriers to new entrants.

A. Delays

9. Because of the detailed nature of franchise agreements, there are inherent delays associated with negotiating these agreements. These delays are anticompetitive because each additional day that the franchising process takes is an additional day that the incumbent enjoys monopoly protection.

10. Multiple sources indicate that there are extensive delays associated with the franchising process. Verizon reports that, during 2005, it conducted franchise negotiations with approximately 320 local franchising authorities, yet obtained only 44 franchises as of year-end 2005, and only seven additional franchises so far in 2006.[5] Of these 51 franchises, 29 are in Texas, where recently enacted legislation enabled Verizon to quickly obtain many of these franchises from the Texas PUC.[6] Verizon explains that, excluding Texas, it has often taken between 6 and 12 months to obtain the franchises that it has been awarded, although many negotiations have taken longer and this range does

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4 The Broadband Service Providers Association notes that there were about 1.4 million subscribers to its member cable systems in June 2004, accounting for a penetration rate (subscribers/homes passed) of about 28%. Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming: Eleventh Annual Report,* MB Docket No. 04-227, (Rel. Feb. 4, 2005) ["FCC Eleventh Annual Report (2005)"], pp. 115-116; Comments of Broadband Service Providers Association, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* MB Docket No. 04-227 (July 23, 2004), p. 7. This implies approximately 5 million homes passed for this competitive sub-market, or about 4.5% of the total U.S. market consisting of 110 million households. FCC Eleventh Annual Report (2005), p. 13.

5 Declaration of Marilyn O'Connell, *In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992,* MB Docket No. 05-311 (Feb. 13, 2006) ["O'Connell Declaration (2006)"], ¶ 8.

6 O'Connell Declaration (2006), ¶ 8.

not include the jurisdictions where Verizon has so far been unable to reach an acceptable franchise agreement.[7] BellSouth similarly reports that it experiences an average negotiation time of 11 months per franchise agreement, with some negotiations running to three years.[8] Wall Street analysts have noted that: "Receiving video franchise approvals has been and will continue to be a time consuming process. The rate at which AT&T and Verizon receive video franchises continues to significantly lag the number of homes passed by [their video networks]."[9] Equipment supplier Alcatel (who has a stake in supplying equipment to new entrants) has stated that the process of petitioning, negotiating, and obtaining cable franchises "could delay competitive wireline video service entry for years."[10]

11. During these periods of delay, the large investments needed to prepare existing phone networks for high-bandwidth video services are held hostage. During the months or years it takes for new entrants to acquire local cable franchises, consumers are penalized by being denied greater competitive choice and the price and quality competition that would result. These delays also impose substantial costs on new entrants and therefore create substantial disincentives to investing in new video networks.

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[7] O'Connell Declaration (2006), ¶ 9.

[8] Comments of BellSouth Corporation and BellSouth Entertainment, LLC, *In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming,* MB Docket No. 05-255 (Sept. 19, 2005) ["Comments of BellSouth (2005)"], p. 3.

[9] Lehman Brothers Equity Research, *Telecom Services – Wireline, Telco Video – 05 Lessons, 06 Expectations* (Jan. 4, 2006) ["Lehman Bros. (2006)"], p. 2.

[10] Quoted in Federal Communications Commission, *In the Matter of Implementation of Section 621(a)(1) of the Cable Communications Policy Act of 1984 as amended by the Cable Television Consumer Protection and Competition Act of 1992: Notice of Proposed Rulemaking*, MB Docket No. 05-311 (Rel. Nov. 18, 2005) ["FCC NPRM"], footnote 28.

And in many markets, franchise negotiations come to an impasse, blocking potential entry altogether.[11]

B. Anti-competitive regulation.

12. Cable franchises typically impose extensive rules governing cable TV systems. These regulations are often so burdensome that they delay or prevent entry. Moreover, under the current process, franchises are rarely uniform and some may *not ever* be issued on reasonable terms and conditions. This balkanization disrupts economies of scale and scope that figure prominently in the construction of advanced video networks.

13. One of the most economically important of the specific regulations imposed by franchises are referred to as "build-out requirements." A build-out requirement commits an operator to a particular system construction schedule; sometimes it includes a designated plan, mandating which neighborhoods are to be served first, which next, and so on. The requirement might stipulate other structural or technological features, or demand that a new entrant "entirely rebuild" an already constructed network.[12] This form of regulation is anti-competitive, both because it announces to the incumbent where it will first face competition and the type of system with which it will compete, and because it substantially raises the costs of the entrant. By reducing the entrant's flexibility in making economic choices about its technological options, how to offer service to customers, how to most efficiently build its facilities, how to manage overlapping system

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[11] In 2001, after spending 2 ½ years attempting to procure a Philadelphia franchise, RCN gave up the effort. Ken Dilanian and Wendy Tanaka, *RCN Pulls Cable-TV Proposal A Senior Company Official Blamed City Council Delays. Phila. Says the Company Left Because of Finances*, THE PHILADELPHIA INQUIRER (Feb. 15, 2001) ["Dilanian & Tanaka (2001)"].

[12] Comments in Support of Petition of Town of Babylon, *Petition for an Expedited Declaratory Ruling of the Town of Babylon, New York et al. Concerning Unfranchised Construction of Cable Television Systems in New York by Verizon Communications Inc. in Violation of the Public Service Law*, State of New York Public Service Commission, Case No. 05-0250 (May 6, 2005), p. 6.

architectures, and so forth, system regulations (including build-out requirements) lower the probability that entry will occur at all.

14. A standard defense of build-out requirements is that they are necessary to ensure that certain areas will be served. This usually is advanced as an "anti-redlining" or "anti-discrimination" imperative. This argument is more than a little ironic given that, until recently, new entrants were denied franchises on the grounds that cable TV was a "natural monopoly,"[13] and now are being told that they should not be allowed to compete anywhere unless they are willing to compete everywhere. In any event, build-out requirements act as a direct tax on competitive entry, thereby reducing such entry and depriving consumers of its considerable benefits.

15. Build-out requirements are also often justified on grounds of fairness, based on the notion that new entrants should be treated the same as incumbents. From an economic perspective, however, requiring a new entrant to build out to the same degree as the incumbent is inconsistent with promoting competitive entry. In telecommunications markets, for example, facilities-based competition emerged market-by-market, precisely because competitors were permitted to enter on a small scale and then grow, incrementally, as their business plans and capital markets permitted.

16. In any event, the so-called fairness argument is based on faulty facts. Incumbent cable operators have rarely, if ever, been subject to actual universal service requirements. Many existing cable TV systems were initially constructed without any build-out requirement. Those systems that were historically subject to franchise construction schedules have typically been exempted from shouldering the burden of

[13] *See, e.g.*, Thomas W. Hazlett, *Private Monopoly and the Public Interest: An Economic Analysis of the Cable Television Franchise,* V134 UNIVERSITY OF PENNSYLVANIA LAW REVIEW 1335 (1986).

extending service to low density areas. This lower limit has often been set at 30 homes per mile (of cable plant), which is about 1/3 the average density for U.S. cable TV systems.[14] Where obligations to serve these low density areas were imposed, cable operators have generally not been required to bear the financial burden of wiring these areas. In many cases, cable operators did not meet even these less-than-universal build-out requirements and demanded franchise "givebacks" – an industry term of art in the 1980s.

17. Far from promoting a level playing field, build-out requirements have the opposite effect, imposing large entry barriers on new entrants. At the time most cable systems were initially built, cable operators anticipated capturing 100% of cable TV subscribers, which mitigated the economic effect of any build-out requirements. New entrants, however, must instead win subscribers against established incumbents. Thus, what may be economic for a first entrant – an operator that will achieve 100% market share among local cable TV subscribers – is distinct from what is economic for a second entrant – an operator who hopes to achieve somewhere around 50% market share at prices 15% or more below the non-competitive level. Hence, the obligation to serve a neighborhood with 30 homes per mile is relatively more expensive per mile for a competitive entrant than for an exclusive franchisee, given that the entrant anticipates sharply lower retail prices and reduced market share.

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[14] See, e.g., Cable Television Franchise Agreement by and between the City of Palo Alto, California on Behalf of the Joint Powers and TCI Cablevision of California, Inc. (July 24, 2000), Section 7.10.2 (2)(b), available at http://www.city.palo-alto.ca.us/cable/franchise-agreement.html. According to the NCTA, there are more than one million miles of cable plant and approximately 110 million occupied homes passed by cable, equating to an average density of less than 110 homes per mile. *See Cable & Telecommunications Industry Overview 2003: Mid-Year,* National Cable & Telecommunications Association (2003), p. 2; *Industry Overview,* National Cable & Telecommunications Association, available at http://www.ncta.com/Docs/PageContent.cfm?pageID=86.

18. Other franchise practices impose significant burdens on entrants. For example, new rivals have been required to make substantial payments to support production costs for programming public, educational, and governmental channels, or to construct institutional network facilities for government use.[15] They are often required to pay large application and/or acceptance fees that can cost tens of thousands of dollars or more. New entrants may also be required to pay the attorneys' and consultants' fees that are incurred by the franchising entities both to negotiate the terms of entry and to indemnify communities while underwriting litigation costs to defend a granted franchise in the face of incumbent cable company threats of litigation.[16]

19. Even when these requirements nominally mirror requirements contained in the incumbent's franchise agreement, they tend to have an asymmetric effect on the new entrant relative to the incumbent, as with the build-out rules discussed above. A requirement to fund $500,000 per year in programming costs for public access programs, for instance, is less affordable to a firm that anticipates competitive profits than for a firm earning monopoly returns. Cumulatively, franchise fees and costly requirements on top of franchise fees are more likely to reduce operating profits to below the cost of capital in a competitive market than in a non-competitive one.

20. Cable operators recognize the disproportionate financial impact that franchise requirements have on new entrants. They have accordingly lobbied for state "level playing field" laws that attempt to impose obligations, via the franchises issued

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[15] Thomas W. Hazlett and George S. Ford, *The Fallacy of Regulatory Symmetry: An Economic Analysis of the 'Level Playing Field' in Cable TV Franchising Statutes*, V3 N1 BUSINESS & POLITICS 21 (2001) ["Hazlett & Ford (2001)"], p. 26, footnote 31.

[16] O'Connell Declaration (2006). Not all threats are idle. Cablevision tried to judicially overturn a Verizon franchise in New York State. *Cablevision Systems Long Island Corp. v. Village of Massapequa Park, et al.*, NY Sup. Ct. Nassau County, filed Oct. 17, 2005.

entrants, that are "at least as burdensome" as those on monopoly incumbents. The existence of nominally symmetric obligations can result in highly discriminatory economic burdens.[17] The actual motivation for such statutes is candidly portrayed in the trade press, where "level playing field" measures are hailed as "anti-overbuild" laws,[18] or as a "weapon in fight against overbuilders."[19]

21. Cable operators also attempt to impose "level playing field" requirements by insisting on "most favored nations" clauses in their franchise agreements. These clauses typically stipulate that franchise requirements will become non-binding should a competitor receive permission to operate with a "less burdensome" franchise. The economic reality is that competition changes the incumbent's ability and willingness to comply with costly regulations. If this is the case – that a given franchise is profitable only with legal barriers protecting the incumbent from an entrant – the reverse is also true. That is to say that if the competitive entrant is subjected to regulatory obligations that are profitable only for sole franchisees, the potential rival will be deterred.

II. UNREASONABLE FRANCHISING PRACTICES DO NOT HAVE OFFSETTING BENEFITS, AND THEIR PUBLIC OBJECTIVES CAN BE ACCOMPLISHED THROUGH MUCH MORE EFFICIENT MEANS

22. As described above, certain unreasonable practices associated with the franchise process impose entry barriers that reduce competition. These unnecessary practices do not provide offsetting benefits. The experience with telephone and

[17] Hazlett & Ford (2001).
[18] Paul Kagan Associates, Inc., *California Anti-Competition Bill Pending,* CABLE TV FRANCHISING (Aug. 31, 1988); John Wolfe, *Florida Operators Gain Weapon in Fight Against Overbuilders*, CABLEVISION (June 15, 1987) ["Wolfe (1987)"], p. 50.
[19] Wolfe (1987), p. 50.

broadband competition illustrates. Local entry regulation was eliminated in both markets, and competition has emerged as a result.[20]

23. The franchising practices discussed in Section I are typically justified on the grounds that they help ensure that cable operators take into account the interests of local residents in exchange for the use of public rights-of-way.[21] The problem, however, is that policies that overtax entrants reduce social welfare by artificially limiting competition.

24. Over-regulating entry is an anti-consumer policy because competition has proven so effective as a consumer protection device. For example, in repeated attempts at cable rate regulation, it has been shown that price caps have failed to reduce quality-adjusted cable TV rates.[22] Yet, it has been regularly observed in data produced by the Government Accountability Office, the Federal Communications Commission, and in numerous surveys and scholarly studies, that head-to-head wireline video competition reliably lowers prices by 15% or more.[23] Deterring competitive entry with rules that ostensibly aim to protect consumers is entirely counter-productive.

25. The pro-consumer approach is to avoid an industrial policy that attempts to impose regulation-defined parity.[24] This path is traveled by permitting, or embracing, the lowest-cost methods for allowing competitive use of public rights-of-way. This creates proper incentives in using public (or private) resources, while promoting consumer

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[20] Thomas W. Hazlett and Coleman Bazelon, *Regulated Unbundling of Telecommunications Network: A Stepping Stone to Facilities-Based Competition?,* paper presented to the Telecommunications Policy Research Conference (Sept. 2005), available at
http://web.si.umich.edu/tprc/papers/2005/503/Stepping%20Stone%20TPRC.10.04.05%20.pdf.

[21] Hazlett & Ford (2001), p. 30.

[22] Thomas W. Hazlett and Matthew L. Spitzer, Public Policy Toward Cable Television: The Economics of Rate Controls (MIT Press, 1997) ["Hazlett & Spitzer (1997)"], Chapters 5 & 6.

[23] *See* footnotes 65, 66 and 67 of this paper.

[24] Hazlett & Ford (2001).

interests in competitive, lower priced, higher quality services. This is the approach adopted with respect to local telephone and broadband entry. In these markets, additional franchises do not have to be negotiated for existing local networks to supply new services to consumers.[25] In broadband, no additional authorizations are needed. In voice, entrants obtain the right to offer service via perfunctory regulatory approvals from state commissions. Given these low barriers, competition has been unleashed.

26. In the 1996 Telecommunications Act, state governments were pre-empted from enforcing policies that legally protected incumbents from entrants, and the policy – simple and unequivocal – worked.[26] Hundreds of competitive local exchange carriers entered phone markets, allowing customers and capital markets to determine market structure.[27] The policy allowed cable operators, for example, to upgrade their networks and to offer fixed line telephony service. As of September 2005, some 49 million U.S. households (about 44% of the national total) were able to purchase standard telephone service from their cable provider.[28] In addition, virtually every U.S. household can subscribe to Internet telephone service (such as is provided by Vonage or Skype) using a cable broadband service.[29] Revealingly, it is considered a very important factor in the recent emergence of VoIP that applications providers (again like Vonage or Skype) do

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[25] It should be noted that DBS operators do not need to acquire local cable TV franchises, nor should they, despite the "inequity" that they compete with local cable TV franchisees.

[26] Cable TV operators are not subjected to the regulatory requirements shouldered by incumbent local exchange carriers (ILECs) when they (the cable operators) provide local phone service. The ILEC is subject to extensive universal service, interconnection, and retail rate regulations, for instance, that are not imposed on the cable TV entrant. The lack of parity does not control public policy; rather, the policy seeks to advance efficient market outcomes.

[27] *The State of Local Competition 2003*, ASSOCIATION FOR LOCAL TELECOMMUNICATIONS SERVICES (Apr. 2003), p. 7.

[28] *Research Notes,* LEICHTMAN RESEARCH GROUP, INC. (Q4 2005) ["LEICHTMAN (Q4 2005)"], p. 6, available at http://www.leichtmanresearch.com/research/notes12_2005.pdf.

[29] Cable modem coverage estimated by Leichtman to equal 98% of total homes passed by cable TV systems, reported as 109.5 million homes as of the third quarter, 2005. LEICHTMAN (Q4 2005), p. 6.

not need state common carrier franchises, are not subject to quality of service rules, and face no build-out requirements.[30]

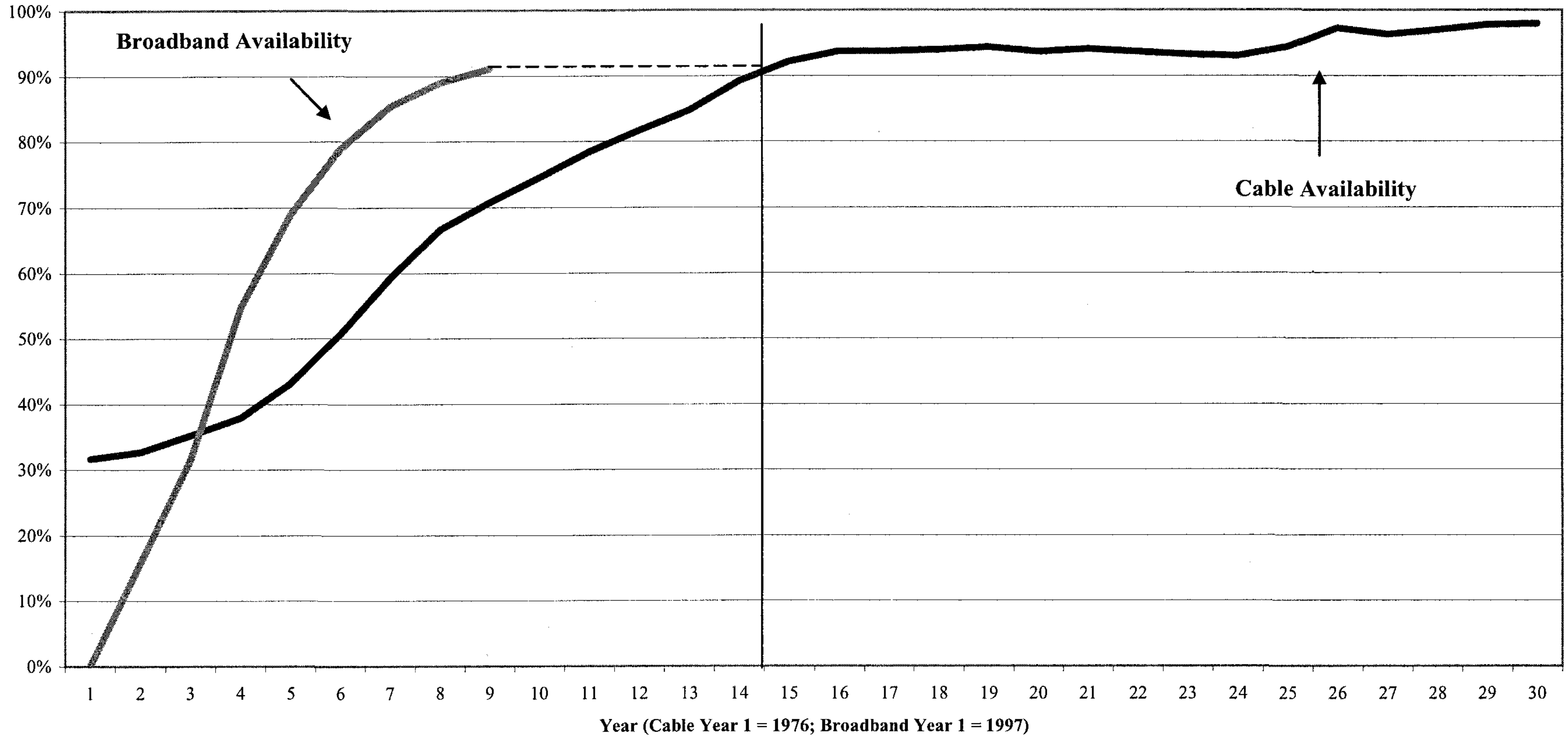
27. The experience with broadband services is similar. Residential markets throughout the country have been wired for high-speed Internet access by both cable TV operators and telephone carriers without the tripwire of local franchises. Either network has the right to provide additional services, entering broadband markets under existing franchise agreements. No build-out requirements have been levied on entrants.

28. The unregulated regime has led to much more rapid deployment than the regulated cable regime. This is seen in examining build-out patterns over time, comparing cable TV to broadband.

29. In Fig. 1, the historical build-out of U.S. cable TV markets is shown, setting Year 1 = 1976. From that date, when cable TV plant passed about 30% of U.S. households, it took another decade until 75% of U.S. households could receive service. By 1990, about 90% saturation was achieved, and in 1995, 95% of homes were passed by cable plant. Hence, even with a 30% "head start," nationwide build-out took well over a decade under a franchising regime that frequently imposed build-out requirements.

[30] Jonathan E. Nuechterlein and Philip J. Weiser, Digital Crossroads: American Telecommunications Policy in the Internet Age (MIT Press, 2005), pp. 204-205.

Fig. 1. Broadband v. Cable Build-out
(as % of Total Households)



Sources:
1976 - 2003 data from Thomas W. Hazlett, "Cable Television," Chapter 6 in Martin Cave, et al., eds., Handbook of Telecommunications Economics, Vol. II (North Holland, 2005), Table 2.
2004 data for homes passed by cable as percent of total households from Federal Communications Commission, *In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Eleventh Annual Report*, MB Docket No. 04-227, (Rel. Feb. 4, 2005), p. 13.
2005 data for homes passed by cable from National Cable & Telecommunications Association Website, available at http://www.ncta.com/Docs/PageContent.cfm?pageID=86.
2005 U.S. Household data from U.S. Census Bureau, *Income, Poverty and Health Insurance Coverage in the United States: 2004, Current Population Reports, Series P60-229* (Aug. 2005), available at www.census.gov/prod/2005pubs/p60-229.pdf.
Data for broadband availability as percent of homes passed by cable from National Cable & Telecommunications Association, In the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, MB Docket No. 05-255 (Sept. 19, 2005), p. 33. Assumed zero broadband availability for 1997; the mid-point between 1997 and 1999 is taken to be the broadband availability for 1998.

30. Also seen in Fig. 1 is the build-out pattern for residential broadband service. Year 1 is set to 1997, when the national saturation ratio was approximately zero. In just five years, from this standing start, broadband was made available to 75% of U.S. households.[31] And by 2005, 91% of U.S. households could subscribe to at least one wireline broadband network (cable modem service), with the great majority of these households having a choice between two or more rival platforms.[32]

31. This comparison shows that technology adoption occurred much faster in broadband than in cable TV. Thus, entry regulation does not appear to have effectively extended service availability when measured from the 'big picture' perspective of national saturation rates. This perspective is entirely appropriate, in that it most broadly observes the availability of service to the public, the ostensible rationale behind the regulation of network construction schedules.

32. The experience gleaned from other government entry regulations is also instructive. Consider the Interstate Commerce Commission's procedures for issuing "certificates of convenience and necessity"[33] to new competitors in surface freight, or the Civil Aeronautics Board's parallel procedures in airline routes. As a result of these practices, competition was stifled for decades.[34] Both of these agencies were abolished

[31] I note that these data on broadband build-out, taken from the NCTA, differ somewhat from the Leichtman data cited above.

[32] By 2004, almost 95 million U.S. homes had access to DSL service. *See* Douglas Mitchelson and Christopher Gilbert, *Cable/Sat Spotlight: 1Q05 Preview,* DEUTSCHE BANK EQUITY RESEARCH (Apr. 27, 2005), p. 10.

[33] *See e.g., American Trucking Ass'ns, Inc., et al. v. United States et al.,* 326 U.S. 77 (1945), available at http://caselaw.lp.findlaw.com/scripts/getcase.pl?court=us&vol=326&invol=77.

[34] W. Kip Viscusi, Joseph E. Harrington, Jr. and John M. Vernon, eds., Economics of Regulation and Antitrust – 4th Edition (MIT Press, 2005) ["Viscusi, et al. (2005)"], p. 597; Alfred E. Kahn, Lessons from Deregulation: Telecommunications and Airlines After the Crunch (AEI-Brookings Joint Center for Regulatory Studies, 2004) ["Kahn (2004)"], Chapters 1 & 2.

by Congress, with such regulatory barriers seen as inherently anti-competitive.[35] There was no advantage to consumers in blocking efforts by new companies, so long as they could attract capital from investors. Arguments against free market competition focused on the use of regulation to extend service to high-cost areas, but not only did enhanced competitive enterprise promise to swamp any asserted offsets, it was clear that more efficient mechanisms for subsidizing particular users or services existed. The results of deregulation have produced huge social gains, proving this pro-competitive policy correct.[36]

33. Finally, the entry barriers imposed by unreasonable franchising practices are particularly unnecessary with respect to telephone companies, which are *already* regulated in their use of rights-of-way, and must obey general rules concerning public disruption. There is no efficiency reason for mandating duplicative, unproductive administrative processes on entrants when streamlined procedures are equally as effective. Once a firm has acquired status as a common carrier provider of telecommunications service in a market, video entry should be as frictionless as broadband service provision is for a cable TV operator or a local telephone carrier.

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35 Viscusi, et al. (2005), p. 608; Kahn (2004), p. i.

36 Viscusi, et al. (2005), p. 603; Kahn (2004), p. 3; Steven A. Morrison and Clifford Winston, *The Remaining Role for Government Policy in the Deregulated Airline Industry,* in Sam Peltzman and Clifford Winston, eds., Deregulation of Network Industries: What's Next? (AEI-Brookings Joint Center for Regulatory Studies, 2000), p. 2; Clifford Winston, *You Can't Get There From Here: Government Failure in U.S. Transportation,* 17 THE BROOKINGS REVIEW 36 (Summer 1999). Even with respect to serving high cost areas, it is not clear that deregulation caused a decline in service. For example, in the case of airlines, while it was predicted the service to smaller cities and towns would suffer as a result of deregulation, evidence suggests that it has actually improved. Alfred Kahn, former chairman of the Civil Aeronautics Board, states that the small towns and rural communities experienced a 35 to 40 percent increase in the number of scheduled departures and an increase in the number of destinations available to them after deregulation. Alfred E. Kahn, *Airline Deregulation,* available at http://www.econlib.org/library/Enc/AirlineDeregulation.html; Thomas Gale Moore, *U.S. Airline Deregulation: Its Effects on Passengers, Capital, and Labor,* 29 JOURNAL OF LAW AND ECONOMICS (Apr. 1986). The latter benefit is attributable to the widespread adoption of the hub-and-spoke system made possible by deregulation. Viscusi, et al. (2005), pp. 618-622.

Additional video rules – such as franchise fees, PEG (public, educational, or government) channel set-asides, must-carry, or customer service rules – can be imposed as general policies applying to all providers, eliminating the costs, delays, and deterrent effects of franchising. Such requirements should be modest, designed to encourage – first and foremost – market competition. This is the general pattern followed in direct broadcast satellite (DBS), a wireless technology bringing two additional subscription video services to U.S. households, but where licensees have certain obligations with respect to public interest programming.[37] Under this approach, communities can guard against external costs by existing rules governing use of rights-of-way or potentially disruptive activities (such as construction projects). The delays imposed in negotiating franchises in thousands of local jurisdictions, exceedingly costly to consumers, are eliminated.

III. SOCIAL COSTS OF UNREASONABLE FRANCHISING PRACTICES

34. In this section, I discuss the consumer losses that result from unreasonable cable franchising practices. First, I examine the effect of these practices on entrants and consumers, using two case studies of wireline overbuilders. Second, I apply an economic model to quantify the costs to consumers of preserving these unreasonable practices going forward.

[37] With the 1992 Cable Act, Congress required DBS providers to allocate four to seven percent of their channel capacity for "noncommercial programming of educational or informational nature." Federal Communications Commission, *In the Matter of Implementation of Section 25 of the Cable Television Consumer Protection and Competition Act of 1992; Direct Broadcast Satellite Public Interest Obligations, Report and Order,* MM Docket 93-25 (Rel. Nov. 25, 1998), p. 3.

A. Impact of Unreasonable Local Franchising Practices on New Entrants

35. Today, only about 5% of U.S. households are passed by multiple wireline video providers.[38] As the academic literature demonstrates, certain local franchising practices have played a key role in limiting wireline video competition.[39] The effect of these practices can be observed from case studies involving two of the largest and most important overbuilders, Telesat and RCN. The former no longer exists, having exited the market by the mid 1990s. The latter continues to operate, after financial restructuring in bankruptcy proceedings, and is the largest overbuilder in the country.

1. Telesat Cablevision

36. In 1985, Florida Power and Light Group Capital purchased a small "private cable" operator, Telesat Cablevision. The firm proceeded to obtain cable franchises, offering competitive service in many parts of Florida, including Orange, Hillsborough, and Citrus Counties.[40] Its subscriber base increased from 7,500 to more than 50,000,[41] while spending $100 million to expand the firm's operations between 1985 and 1990.[42] In markets where it operated, incumbents slashed prices and expanded program menus, with consumers enjoying both improved service and a choice of operators. After this

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[38] *See* footnote 4, above.

[39] *See, e.g.,* Thomas W. Hazlett, *Predation in Local Cable TV Markets*, 40 ANTITRUST BULLETIN 609 (Fall 1995); Hazlett & Ford (2001); Reza Dibadj, *Toward Meaningful Cable Competition: Getting Beyond the Monopoly Morass,* 6 NEW YORK UNIVERSITY JOURNAL OF LEGISLATION AND PUBLIC POLICY 245 (2003); Patrick Bolton, Joseph F. Bradley, and Michael H. Riordan, *Predatory Pricing: Strategic Theory and Legal Policy,* 88 GEORGETOWN LAW JOURNAL 2239 (Aug. 2000). Bolton, Bradley and Riordan feature an example of predatory pricing involving cable markets, writing that "regulatory hurdles" help predatory behavior succeed. The franchise process is generally considered to be a main barrier to entry in offering cable service. Ibid, pp. 2292-2293.

[40] Cited in Comments of Telesat Cablevision, Inc., *In the Matter of Competition, Rate Regulation and the Commission's Policies Relating to the Provision of Cable Television Service,* MM Docket No. 89-600 (Mar. 1, 1990) ["Telesat (1990)"], p. 19.

[41] Telesat (1990), pp. 1, 4.

[42] Telesat (1990), p. 5.

initial period of expansion, unreasonable franchising practices were imposed that impeded further growth. As Telesat explained:

> In several areas, Telesat effectively has been denied access. Where Telesat has been successful in obtaining franchises, it is often at the cost of accepting operating requirements, such as universal or "rural-first" build-out provisions, which are far more onerous than those imposed upon the existing operators.[43]

37. After being denied the opportunity to obtain franchises on reasonable terms in Parkland, Collier County, and Dade County, Telesat complained about the anticompetitive franchising process, and Florida's protectionist "Level Playing Field" statute, to the FCC.[44] The company documented a litany of anti-competitive practices:

> Even where Telesat has succeeded, it has done so only after enormous expenditures of time and resources, not to mention legal and consulting bills far, far out of proportion to a company of its size... The net effect of this intensive, orchestrated opposition campaign has been exactly what Telesat's opponents intended: to direct far too great a proportion of Telesat's resources to legal and regulatory purposes, and far too little to building and operating competitive cable services.[45]

38. The policy response, including measures adopted in the 1992 Cable Act, were insufficient to remedy the situation. FPL Group Capital sold Telesat in 1992-94,[46] abandoning a competitive foray that had lowered prices and improved service for tens of thousands of households. The systems sold by Telesat were consolidated with their direct rivals, and substantial price increases were imposed on consumers in several Florida

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43 Telesat (1990), p. 2.

44 Telesat (1990).

45 Telesat (1990), p. 20. The company reported that "in 1989, a year in which Telesat had total operating revenues of $10.24 million, the company had over $1 million in defensive legal costs." Ibid.

46 Mark Robichaux, *Captive Audience: Cable Firms Say They Welcome Competition But Behave Otherwise --- Some Established Systems Go To Great Lengths to Keep Rivals Out of the Game --- A Nasty Battle in Niceville*, THE WALL STREET JOURNAL (Sept. 24, 1992), A1; T. Christian Miller, *Telesat Tells County It Just Can't*, ST. PETERSBURG TIMES (Aug. 11, 1994), Citrus Times, p. 1.

markets.[47] Even more importantly, the competitive business strategy was thwarted; not only did Telesat abandon efforts to expand rivalry into additional markets, other potential entrants were likely deterred.

2. RCN

39. RCN has gone through three distinct stages as a competitive wireline video provider. First, from the late 1990s though 2000, RCN sought to enter a large number of markets and viewed expensive franchising obligations as anticompetitive barriers. Second, RCN struggled to remain financially solvent from 2001 to 2003 and intensified its view about unreasonable franchising practices while it attempted to renegotiate some of those franchise obligations. Finally, after reemerging from bankruptcy in May 2004 and restructuring its operations, RCN has abandoned geographical expansion plans and has supported expensive franchise obligations for new entrants.

40. This progression of views demonstrates the economic effects of municipal cable franchise obligations. Firms seeking to enter the market view these obligations as barriers to entry and tend to oppose such franchise rules, regulations, delays, or transaction costs. Firms already in the market tend to favor them.

1. Late 1990s – 2000: Expansion Phase

41. As RCN was expanding, seeking franchise approvals as an aspiring entrant in several cable TV markets, RCN denounced various franchising practices as unduly burdensome. For example, in comments filed with the FCC in 2000, RCN wrote:

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47 *Florida Rival Bought Out,* THE WALL STREET JOURNAL (Dec. 10, 1992), A13; Will Wellons, *Small Turnout at Cable TV Forum United Against Sale,* ORLANDO SENTINEL (Feb. 24, 1993), A4; Susan G. Strother, *Cablevision Buyout of Telesat Ends Costly Showdown,* ORLANDO SENTINEL (Dec. 12, 1992), C1.

> In a large number of major urban markets, RCN has encountered within the last year local officials who seem intent on burdening RCN with ever-increasing financial and service obligations. Delays follow delays while municipal officials creatively search for new ways to extract goods services or payments from RCN. In addition, several municipalities are delaying RCN's attempts to obtain telecommunications right-of-way agreements and/or cable franchises until RCN agrees to a franchise on its Internet services, a requirement to which other Internet service providers are not subject. RCN has been negotiating in a number of west coast markets for eight to nine months without yet seeing a definite end to the process.[48]

42. Philadelphia presented numerous obstacles. While RCN began its quest for a cable TV franchise in 1998, it withdrew its application in early 2001, citing the city's anticompetitive process.[49] Significantly, RCN was not formally denied a franchise. Rather, franchise authorities attempted to impose terms that were not reasonable and would render the business opportunity moot. Its 2001 Annual Report noted:

> In Philadelphia, we experienced significant delays in securing authorization from the city to provide cable or OVS [open video service] service on commercially reasonable terms. As a result, RCN has withdrawn from such negotiations with the city and has no present plans to build out its system in Philadelphia.[50]

43. It is important to consider that RCN had sought the Philadelphia franchise in conjunction with its effort to secure other area franchises. Indeed, it obtained rights to

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[48] Comments of RCN Corporation, *In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming*, CS Docket No. 00-132 (Sept. 8, 2000), p. 25. *See also*, Minutes from a PA-COMNET Meeting on July 7, 1999: "RCN wants cities to sign agreements, not require franchises," available at http://www.pa-comnet.org/meetings/19990707-minutes.html.

[49] Edmund Sanders, *Comcast Country Tough on Intruders; Cable: As at Least One Would-be Rival Found, a Large Base of Support and Loyalty Exists in Philadelphia,* LOS ANGELES TIMES (July 16, 2001), Business, p. 1. According to a February 2001 PHILADELPHIA INQUIRER story:

> Scott Burnside, RCN's senior vice president for regulatory and government affairs, accused Council of buckling to the influence of Philadelphia-based Comcast Corp., the region's dominant cable provider. RCN had been seeking the city's approval of its plan to compete with Comcast in Philadelphia for 2 1/2 years. "It's been very clear to us that the City of Philadelphia, or at least some city politicians, just would prefer not to have competition," Burnside said in an interview yesterday.

Dilanian & Tanaka (2001).

[50] RCN Corporation, Securities and Exchange Commission Form 10-K (for year ending Dec. 31, 2001), p. 20.

serve fifteen Philadelphia suburbs, as the company reported in early 2000.[51] This has allowed RCN to offer competitive video, broadband, and phone service in suburban markets, but has effectively prevented entry in adjacent urban areas within the City of Philadelphia. The delays imposed by cable franchising barriers historically resulted in similar outcomes in other major cities, including New York, Washington, D.C., and Chicago, where urban cable TV service was delayed for years or decades.

44. In addition to the unfortunate outcome in each instant case, the barriers continue to discourage further competitive forays. When franchise rights are balkanized, such that some neighboring markets can be served while others cannot, powerful economies of scale are stifled. Within the cable TV sector, in fact, substantial merger activity over the past decade or so has produced efficiencies associated with system clustering. Cable operators enjoy lower costs when they can group their operations together across an entire region. Disrupting such cost savings undermines the business case for competitive entry altogether.

2. 2001 - 2003: Financial Distress Phase

45. In 2001-2003, RCN scaled back its expansion plans.[52] In this retrenchment, RCN also missed franchise build-out deadlines in existing franchises. In Boston, RCN had signed a franchising agreement in July 1999 that required a 90 percent build-out

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[51] "[W]e just received approval to service fifteen Philadelphia area suburbs, expanding our reach in this important market." *Paul G. Allen's Vulcan Ventures Closes $1.65 Billion Investment in RCN; Vulcan Funding Positions RCN to Continue Rapid Expansion Into Markets Which Meet Its Density and Regulatory Requirements*, PR NEWSWIRE (Feb. 28, 2000).

[52] *RCN Outlines 2001 Plans for Growing Its Local Broadband Business; Current Markets Are Pre-Funded to Free Cash Flow,* PR NEWSWIRE (Dec. 21, 2000). *See also,* K.C. Neel, *Deadend at the Headend? For Cash-poor Overbuilders, Time May Be Running Out,* 14 CABLE WORLD (Mar. 18, 2002), at p. 17.

within three and a half years and a 100 percent build-out within six years.[53] While exact figures on RCN's homes passed are difficult to obtain, reported RCN subscribership and local news reports suggest that RCN has failed to construct its system on schedule. For example, local newspaper accounts around the end of 2002 reported the following:

> RCN, the company that was supposed to provide a blast of competition in Boston, has not proven to be a player.[54]
>
> AT&T may be facing limited competition from RCN Corp.[55]
>
> RCN, the one company that announced its intention to compete in Boston and other communities, has failed to mount a serious threat.[56]

46. According to figures reported in Warren Communications News' Television & Cable Factbook 2006, Cable Vol. 1, RCN has 11,000 basic service subscribers in Boston.[57] That compares to 153,000 Comcast basic service subscribers and 285,000 homes passed by Comcast in Boston.[58] Given that RCN reports that, company-wide, it serves about 27 video subscribers for every 100 homes passed,[59] this suggests that the 90% and then 100% build-out mandated in the franchise was not achieved.

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[53] Federal Communications Commission, *In the Matter of Cablevision of Boston, Inc. Petition for Determination of Effective Competition, Memorandum Opinion and Order*, DA 01- 1731 (Rel. July 20, 2001), p. 4; *Boston Strikes Deal with RCN*, THE BOSTON HERALD (Jul. 29, 1999).

[54] Monica Collins, *Television; Outlook's Fuzzy for Improving Cable Service*, THE BOSTON HERALD (Nov. 21, 2002), p. 055.

[55] Bruce Mohl, *Consumer Beat; Satellite Is Dishing Out Competition to Cable*, THE BOSTON GLOBE (Dec. 8, 2002), G3.

[56] Monica Collins, *Television; Cable Beast Tightens Its Grip on Our Wallets*, THE BOSTON HERALD (Jan. 16, 2003), p. 039.

[57] Television & Cable Factbook 2006, Cable Vol. 1 (Warren Communications News, 2006) ["Television & Cable Factbook (2006)"], D-733.

[58] Television & Cable Factbook (2006), D-733.

[59] RCN reports that, in 2003, it had 540,000 video subscribers among the 1,965,000 homes passed by its systems. *See* RCN Corporation, Securities and Exchange Commission Form 10-K (for year ending Dec. 31, 2003), p. 9.

47. RCN received approval to serve three franchise areas in Chicago's northwest, west and southwest neighborhoods in November/December 2000.[60] The terms of the agreement included a provision for RCN to lay 676 miles of cable in the three Chicago areas. However, by 2003, RCN renegotiated its obligations to build-out two of the areas, and filed a motion to withdraw its obligation to build-out the third area. The firm's 2003 construction plan included laying just 3.54 miles of cable.[61]

3. 2004 - Present: Post-Bankruptcy Phase

48. RCN filed for bankruptcy in May 2004.[62] In reorganization, RCN was able to further renegotiate its franchise obligations.[63] Having curtailed efforts to expand to new markets, the firm has now become a franchise-holding incumbent entirely sympathetic to the imposition of barriers to additional entry:

> RCN believes that the current emphasis on local franchise relief for the RBOCs entering the MVPD market is a red herring; pricing and programming are the pressing issues. RCN, despite being far smaller than the RBOCs, successfully obtained some 130 local cable franchise and open video system ('OVS') agreements. The real impediments to competition are the program access and price problems that RCN and other competing MVPDs have long complained of.[64]

49. The achievement noted, gaining 130 franchises, must be seen in context of the firm's ultimate failure to continue its competitive strategy. Franchise delays, transaction costs, and uneconomic requirements – seen in the firm's real-time

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[60] *RCN Receives Approval to Expand its Service in Chicago; Agreement Triples Potential Homes in Market*, PR NEWSWIRE (Nov. 10, 2000); Art Golab, *Lakefront Cable Firm May be Fined by City for not Expanding*, CHICAGO SUN-TIMES (Feb. 6, 2004) ["Golab (2004)"], p. 11; *Cable Panel OKs $1 Million-a-day Penalty for RCN*, CHICAGO TRIBUNE (Feb. 22, 2004) ["CHICAGO TRIBUNE (2004)"], p. 4.

[61] Golab (2004), p. 11; CHICAGO TRIBUNE (2004), p. 4.

[62] *Cable Firm RCN Files for Bankruptcy*, THE PHILADELPHIA INQUIRER, (May 28, 2004).

[63] For example, RCN was able to reach an agreement with the city of Chicago in which it was able to get out of its remaining build-out requirements. *See RCN, Chicago Settle Their Dispute*, THE DEAL, (Dec. 1, 2004).

[64] Comments of RCN Telecom Services, Inc., *In the Matter of Annual Assessment of the Status of Competition in Markets for the Delivery of Video Programming,* MB Docket No. 05-255 (Sept. 19, 2005), p iii.

documentation of its experience – contributed to investors' financial demise. Moreover, this financial failure allowed the firm to undo the terms and conditions of many of its franchises, obligations that it now recommends for other firms. Clearly, if firms are forced to go into receivership prior to gaining economic franchise terms, there will be under-investment in competitive facilities.

B. Quantifying Consumer Losses Associated With Entry Barriers

50. Competitive entry into the video marketplace will significantly increase consumer welfare by reducing prices, improving service, and expanding the number of video subscribers. Delay will diminish or eliminate these potential social welfare gains. And the losses associated with such delay are unrecoverable – higher prices paid by consumers in the near term are not offset by lower prices in the future.

51. It is possible to estimate the consumer benefits from competitive entry into video using an economic model that calculates the losses associated with delayed entry. The model used here focuses on nationwide entry by wireline MVPD providers. The approach calculates the consumer gains from competitive entry under current rules (which result in franchise delays) and then measures the consumer benefits from accelerating that entry (via policies that remedy franchise delays).

52. Exhibit 1 contains a detailed description of the economic model used. To summarize, I developed two different scenarios – one that projected the scope of competitive wireline entry absent regulatory reform, and another that calculated the scope of entry assuming regulatory reform (and reduced franchise barriers) beginning in 2007. I then estimated the consumer benefits of entry using historical data from the GAO and FCC on the effects of wireline rivalry on cable prices. The difference between the

benefits achieved in the second scenario (with regulatory reform) and the first scenario (without such reform) represents the benefits of accelerated entry or, to put it differently, the costs of delayed entry. Using conservative assumptions, I estimate potential consumer benefits of accelerated entry to be in the range of $16 billion to $28 billion, in present value terms. This projection assumes that competitive wireline entry occurs nationwide. While it is impossible to know whether this result would obtain, the assumption is made in *both* the baseline and accelerated scenarios. Given that the scope of competitive entry will certainly be greater with lowered regulatory impediments, the analysis produces a conservative projection of the benefits of pro-consumer reforms.

CONCLUSION

53. A number of current franchising processes erect substantial barriers to entry. These barriers are uneconomic and alternative regulatory mechanisms would achieve the public purposes of franchising at a much lower social cost. The advantages of streamlining entry for new communications services have been vividly seen in the broadband marketplace, where existing cable operators and telephone carriers have expanded service offerings without being subject to onerous and duplicative franchise regulation. By relaxing municipal franchise barriers in multi-channel video, new competition would no longer be deterred by uneconomic regulation, with extremely large consumer surplus gains – between $16 billion and $28 billion – projected to result.

I declare under penalty of perjury under the laws of the United States of America that the foregoing is true and correct.

Executed on February 13, 2006

Thomas W. Hazlett

EXHIBIT 1

This exhibit describes the model used to estimate the consumer benefits that would result from regulatory reform that successfully remedied unreasonable franchising practices.

First, I consider the effect of competitive wireline entry on retail cable prices. The Government Accountability Office (GAO) estimates the price decrease in average consumer bills from wireline entry to be about 15%.[65] The FCC's report on cable prices supports this estimate and further finds that, on a per-channel basis, the price declines were as high as 27%.[66] In both cases, these declines represent the effect of wireline entry after already taking into account the impact of direct broadcast satellite entry into the MVPD marketplace. I use these two estimates of competitive price declines for High and Low scenarios in the analysis here.[67]

Second, I estimate the number of homes to which competitive wireline entrants would be able to provide video services (i.e., homes passed) under two scenarios. The first scenario assumes that there will be no regulatory reform. I start with a January 2006 Lehman Brothers estimate of homes passed by telco competitors, 2004 through 2007.[68] The Lehman Brothers forecast was made with the expectation that the current franchising

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[65] Government Accountability Office, *Telecommunications: Issues Related to Competition and Subscriber Rates in the Cable Television Industry* (Oct. 2003), GAO-04-8 ["GAO (2003)"], p. 3.

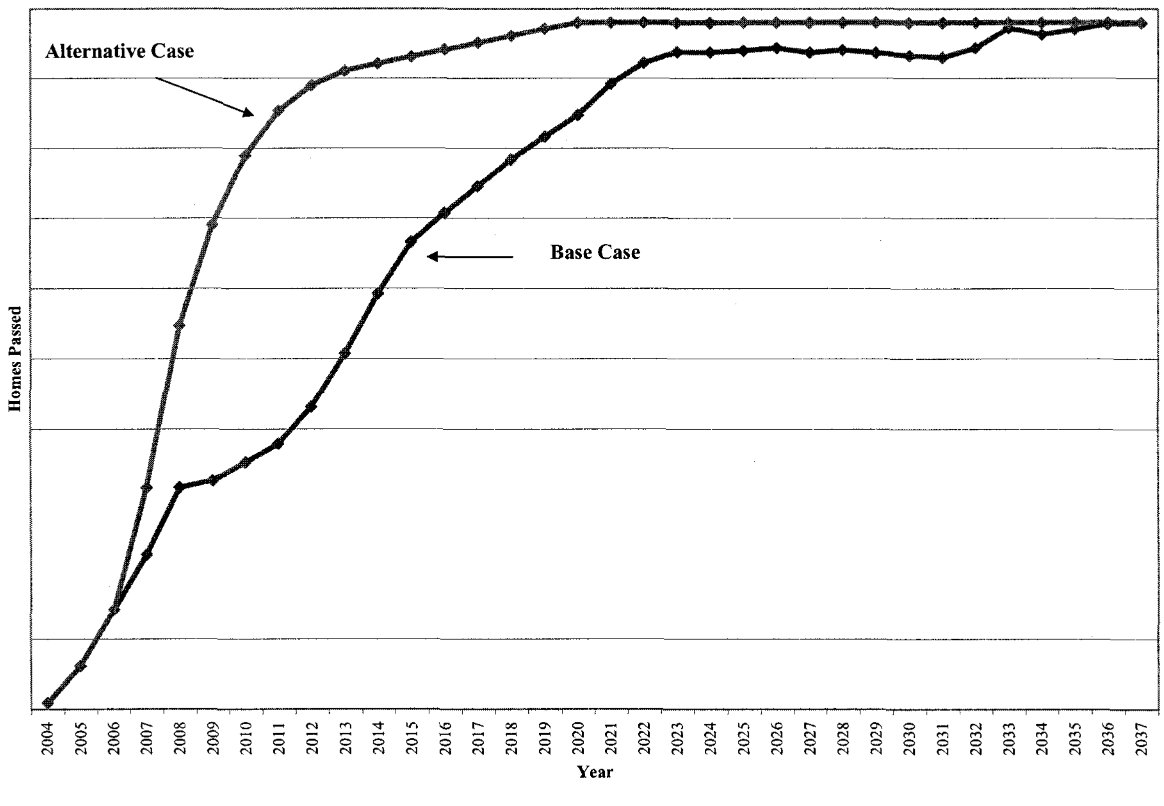
[66] Federal Communications Commission, *In the Matter of Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment,* MM Docket No. 92-266 (Rel. Feb. 4, 2005), ¶ 12.

[67] The range used here is supported by various surveys and academic research. William M. Emmons III and Robin A. Prager, *The Effects of Market Structure and Ownership on Prices and Service Offerings in the U.S. Cable Television Industry*, 28 RAND JOURNAL OF ECONOMICS 732-50 (1997) ("Privately owned cable systems facing direct competition from another privately owned cable operator offered basic service at prices that were 20.5% lower in 1983 and 20.1% lower in 1989 than those charged by privately owned monopoly operators." *See also,* Hazlett & Spitzer (1997), pp. 26-33.

[68] *See* Lehman Bros. (2006), pp. 4-5.

regime lasts another year or two, but then is reformed.[69] Consequently, I use these estimates only through 2007. From 2008 onward, I assume that subscriber growth will follow the historical path of cable television deployment from 1976 onwards (as shown in Fig. 1). Given that a large majority of cable television systems were built with local franchises, their historical growth pattern incorporates delays from the franchising process. See Fig. 2.

FIG. 2: COMPETITIVE VIDEO BUILD-OUT



2004 – 2007 data for the base case are the actual and estimated numbers for homes passed by telco competitors (Lehman Bros. (2006), pp. 4-5) as a percent of total U.S. households. Data for the 2008 – 2037 base case, based on the path of historic cable video build-out, presented in Figure 1. Data for the 2007 – 2013 alternative case, based on the path of historic cable broadband build-out, presented in Figure 1. Data for the 2014 – 2037 alternative case based on Analysis Group projections.

[69] "Capital Hill and FCC sentiment leans toward relaxing or lifting local franchising requirements. However, genuine political interest in altering the rules should not affect them until 2007 or 2008 when serious possibility of passage of broader telecom reform could emerge." Lehman Bros. (2006), p. 2.

In the second scenario, I model video entry under the assumption that regulatory reform effectively streamlines the local franchising process, and that this takes effect in 2007. In this case, I then assume that competitive build-out will follow the historical path of cable modem (broadband) deployments in the U.S., which is a useful model for unencumbered telco entry into video. Beginning in 2014, I assume that deployments are increased by about 1 million homes passed per year until saturation reaches 98% in 2020 and then saturation is held constant. First, cable provided broadband was deployed without any additional franchising requirements. Second, it was deployed as an upgrade to existing infrastructure. This parallels the position of telephone carriers that will upgrade existing infrastructure to provide video services. Third, cable modem service was deployed in a market that generally featured at least one additional broadband service provider, similar to the non-monopoly position of a telco entering a video market.

Fig. 2 displays the alternative reform scenario based on franchise relief available in 2007. The two distinct paths for competitive video deployments enable a calculation of the consumer welfare gains from franchising reforms. There were approximately 113.1 million households in the U.S. in 2005[70] and the percentage of cable subscribers equaled 57.8% of households.[71] Price decreases from increased competition will increase the number of subscribers to video services, but the exact level of increase is difficult to pinpoint. Economic analysis suggests that every percentage point decrease in the price

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[70] U.S. Census Bureau, Income, Poverty and Health Insurance Coverage in the United States: 2004, Current Population Reports, Series P60-229 (Aug. 2005), available at http://www.census.gov/prod/2005pubs/p60-229.pdf. I hold the total number of households constant throughout the analysis to simplify the calculations. This simplification does not greatly affect the magnitude of the welfare estimates (it marginally undercounts them) and has an even smaller effect on the estimated welfare effects of accelerating the deployment of competitive multi-channel video.

[71] This is equal to the current number of cable subscribers (65.4 million) divided by total U.S. households (113.1 million). The FCC reports that cable subscribers are 69.4% of the 94.2 million MVPD subscribers. *See* Federal Communications Commission, *FCC Issues 12th Annual Report to Congress on Video Competition* (Feb. 10, 2006), p. 3.

per channel of cable video services will increase the number of subscribers by about 1.5%.[72] Consequently, I assume the number of subscribers will increase by 22.5% with a 15% price decrease and by 40.5% with a 27% price decrease. Many of these new subscribers will come from the current pool of DBS subscribers.[73]

As Table 1 indicates, consumer surplus gains associated with competitive entry into the video marketplace are estimated to be $76 billion to $134 billion (in present value terms) under the base case (assuming no reform). Table 1 also reports the model results assuming competitive entry is accelerated beginning in 2007 to equal the deployment path of unregulated cable broadband. The difference between benefits generated *when entry is accelerated* versus the *base case* measures the irretrievable losses from delay. The present value of consumer benefits of accelerated entry therefore range from $16 billion to $28 billion, assuming competitive wireline entry nationwide across both scenarios.[74]

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72 GAO (2003), p. 59. The 1.5% elasticity relates the change in cable subscribers to a change in the per channel price of cable.

73 Benefits to satellite subscribers from increased wireline entry are, however, ignored.

74 This result does not imply that nationwide build-out by additional wireline video systems would obtain. It derives from the *difference* in consumer gains between a nationwide build-out with and without reforms that effectively streamline competitive entry. It is clear that, whatever path we are currently on for competition to emerge in local markets, the extent of that national build-out pattern will expand with lower entry barriers. Hence, an analysis that projected less than nationwide build-outs for competitive entrants would need to reflect the relatively greater scope of competition under the reform scenario.

TABLE 1. Present Value of Consumer Surplus

	Low Scenario: 15% Price Decrease[A]	High Scenario: 27% Price Decrease[B]
Base Case	$76.1 billion	$134.1 billion
Alternative Case I	$92.0 billion	$162.3 billion
Gains from Accelerated Entry[C]	$15.8 billion	$28.1 billion

Discount rate of five (5) percent used for present value calculations. N, the number of periods for which the Consumer Surplus is discounted, is zero in 2005. Consumer surplus = [(Change in price x Number of subscribers before entry) + (Change in price x Change in subscriber base resulting from entry)/2].
[A] GAO (2003), p. 3.
[B] Federal Communications Commission, *In the Matter of Statistical Report on Average Rates for Basic Service, Cable Programming Service, and Equipment*, MM Docket No. 92-266 (Rel. Feb. 4, 2005), ¶ 12.
[C] Difference not exact due to rounding.

The estimates of consumer gains from accelerated entry presented here are likely to be underestimates. The baseline case assumes widespread competitive entry into the video market even absent franchise reform, which is highly optimistic. As noted, expansion by overbuilders such as Telesat and RCN has ended, and a large and important advanced network deployment, SBC's Project Pronto, was essentially abandoned.[75] Absent reform, some telcos may scale back their entry plans. The costs of delay would then encompass much of the welfare gains – on the order of $100 billion or more, assuming nationwide competitive entry – rather than just the incremental costs associated with delayed entry.

[75] SBC Communications Inc., Securities and Exchange Commission Form 10-K (for year ending Dec. 31, 2003), Item I.

EXHIBIT 2

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1991 - 1992	☼	Chief Economist, Federal Communications Commission

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Fields of Specialization:

Research: Law & Economics, Public Choice, Information Technology Policy
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1990-1991 ☼ Citicorp/Wriston Fellow, Manhattan Institute for Policy Research
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Books:

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Special Teaching Assignments/Lectures:

"The Economic Way of Thinking," Foundation for Teaching Economics, Prague, Czechoslovakia (September 1991).

"The Economic Way of Thinking," Foundation for Teaching Economics, Prague, Czechoslovakia (August 1992).

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"Economic Challenges for the Next Four Years," A Conference for Journalists presented by the Foundation for American Communications, Los Angeles, California (January 1993).

Ministry of Post & Telecommunications Institute, lecture program arranged by Columbia Institute on Tele-Information, Tokyo, Japan (March 1993).

"Nafta, Gatt and Other Four-Letter Words," An economics conference for journalists presented by the Foundation for American Communications, San Diego, California (December 1993).

Institute on Economics for Journalists presented by the Foundation for American Communication, funded by Ford Foundation, Tomales Bay, California (July 1994).

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"The New Congress and the Economy," An economics conference for journalists presented by the Foundation for American Communication, University of Georgia (May 1995).

Institute on Economics for Journalists presented by the Foundation for American Communications, Tomales Bay, California (July 1995).

Center for Market Processes, Congressional Staff Briefing on the economics of regulation, Williamsburg, Virginia (August 1995).

"Spectrum Management," Columbia University's Third Annual International Training Conference for Telecommunications Regulators, New York, New York (November 1995).

"Economics and the '96 Elections," Economics Conference for Journalists presented by the Foundation for American Communications, Greenbrier, West Virginia (April 1996).

Institute on Economics for Journalists presented by the Foundation for American Communications, Jackson Hole, Wyoming, (August 1996).

"Economics for Leaders," Lectures to High School Economics Teachers, Foundation for Teaching Economics, Babson College, Wellesley, Massachusetts (July 1997).

Institute on Economics for Journalists presented by the Foundation for American Communications, Tomales Bay, California (August 1997).

The Stranahan Lecture, University of Toledo School of Law (October 1997)

Distinguished Pantaleon/Concepcion Chair, Universidad Francisco Marroquin, Guatemala (October 1997).

Telecommunications Policy, Seminar for Journalists, Foundation for American Communications, San Diego, California (December 1998).

Institute on Economics for Journalists presented by the Foundation for American Communications, Tomales Bay, California (August 1999).

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Institute on Property Rights for Judges, George Mason University School of Law, Law & Economics Center, Tucson, Arizon (April 2004).

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Consulting (formal and informal):

Turner Broadcasting, U.S. Chamber of Commerce, Major League Baseball, Verizon Wireless, Knology, Northpoint Technology, SMS/800, Satellite Broadcasting & Communications Association, FiberStreet, Gemstar, Telus, Pacific West Cable Company, Preferred Communications, Century Cable, Group W, Telesat Cablevision, Norwest Communications, Total TV, Montgomery Cable and Entertainment, Ohio Bell, Wireless Cable Association, Competitive Cable Association, U.S. Telephone Association, AT&T Wireless, Cingular, Nextel, T-Mobile, Sprint PCS, Cellular Telephone Resellers Association, Western Wireless, NewsCorp, FoxTel, Cablevision Systems, CBS, Pacific Telesis, U.S. West, Bell Atlantic/Verizon, BellSouth, Ameritech, Southwestern Bell, Nynex, Time Warner Telecommunications, Coastal Cable, Southern New England Telephone, McClatchy Enterprises, Viacom, Tandem Computers, White House Office of Policy, White House Council of Economic Advisers, U.S. Department of Justice, Federal Trade Commission, Federal Communications Commission, the National Telecommunications and Information Administration, Government of El Salvador, Government of Guatemala, Government of United Kingdom, European Commission, Congressional Budget Office, U.S. General Accountability Office, County of Santa Cruz, California Department of Justice, California Governor's Office, Progress & Freedom Foundation, Alliance for Public Technology, Common Cause, California Power Exchange, the California Board of Equalization, the U.S. House Commerce Committee staff, and the U.S. Senate Commerce Committee staff.

Oral Testimony:

Before the Joint Economic Committee of Congress on the subject of urban enterprise zones, October1981.

Before the California Public Broadcasting Commission on the subject of cable television deregulation, February 1982.

Before the Compton, California City Council, on the subject of enterprise zones, October 1982. Before the Pacific Grove, California City Council, on the subject of local land-use regulations, February 1984.

Before the Federal Competition Board, Republic of South Africa, on the subject of monopoly and industrial concentration, June 1985.

Before the U.S. Commission on Civil Rights, on the subject of housing market discrimination, November 1985.

Before the Santa Cruz, California City Council, on the subject of municipal franchising of cable television, November 1985.

Before the U.S. District Court for Northern California, in Pacific West v. Sacramento, regarding franchise monopoly in cable television, April/May 1987.

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ATTACHMENT C

THE VERIZON TELEPHONE COMPANIES

For the purposes of this filing, the Verizon telephone companies are the local exchange carriers affiliated with Verizon Communications Inc.:

Contel of the South, Inc. d/b/a Verizon Mid-States
GTE Southwest Incorporated d/b/a Verizon Southwest
Verizon California Inc.
Verizon Delaware Inc.
Verizon Florida Inc.
Verizon Maryland Inc.
Verizon New England Inc.
Verizon New Jersey Inc.
Verizon New York Inc.
Verizon North Inc.
Verizon Northwest Inc.
Verizon Pennsylvania Inc.
Verizon South Inc.
Verizon Virginia Inc.
Verizon Washington, DC Inc.
Verizon West Coast Inc.
Verizon West Virginia Inc.

Federal Communications Commission

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